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Politics this week

May 2nd 2002
From The Economist print edition

Arafat released

EPA

Yasser Arafat was released from a five-month confinement in his compound in Ramallah. Under a deal brokered by America, six Palestinians the Israelis had wanted extradited will be imprisoned or detained in a Palestinian jail under American and British supervision. The Palestinians hoped for a similar deal over the gunmen besieged, with many others, in Bethlehem's Church of the Nativity, but that stand-off continued, with more shooting.

See article: Palestinians welcome internationalisation

The Israeli government, which had accepted the UN Security Council's demand for a **fact-finding team** to go to Jenin, decided after all that the team was not acceptable. Kofi Annan said he would have to abandon the mission since the high-powered team could not be kept waiting indefinitely in Geneva.

See article: Israel and the internationalisation of the Middle East conflict

In **Zimbabwe**, three journalists, including *The Economist*'s Harare correspondent, Andrew Meldrum, were arrested for “publishing falsehoods”. Meanwhile, the Zimbabwean government was elected to the UN Commission on Human Rights.

See article: *The Economist's* Zimbabwe correspondent arrested

Food shortages grew worse in southern Africa, particularly in Zimbabwe, Malawi and Zambia. Drought, combined with misgovernment and the confiscation of commercial farms in Zimbabwe, has caused maize output to plunge and left millions in need of food aid.

After a recount, Marc Ravalomanana was declared the winner of **Madagascar's** presidential election, which was held in December. The incumbent, Didier Ratsiraka, refused to recognise the court's ruling. Governors of four of the country's six provinces, who support Mr Ratsiraka, threatened to secede.

After a peaceful campaign by the 24 candidates vying to replace the outgoing president, **Mali's** election ended in some confusion. There will almost certainly be a second round between the two leading candidates on May 12th.

See article: Mali's pluralist election

Put on its mettle

First results showed that members of **Germany's** big metal-working union, IG Metall, had voted heavily for strike action in pursuit of a pay claim. The first of a series of firm-by-firm strikes is expected on May 6th. But the union, once claiming 6.5% now wants 4%.

An 19-year-old **German** student shot dead 16 people, including 13 teachers and a policeman, before killing himself, in a school he had been expelled from in Erfurt, in the eastern part of the country.

The head of the European Commission, **Romano Prodi**, scolded the British government for cherishing Britain's special relationship with the United States at the expense of European integration.

See article: The EU's Romano Prodi annoys Britain

A populist former general, Alexander Lebed, who came third in **Russia's** presidential election in 1996, was killed in a helicopter crash in Siberia.

Reuters

See article: The legacy of Russia's populist general, Alexander Lebed

Britain's **Queen Elizabeth II**, celebrating her 50th year on the throne and now aged 76, told a joint session of the houses of Parliament of her “resolve to continue” to serve the nation “through the changing times ahead”. Translation: to any who think it time she abdicated, No.

Spain's two main trade-union confederations threatened to call a general strike in June if the government did not withdraw plans to alter the rules on unemployment benefit.

Basque terrorists exploded a bomb outside Real Madrid's football stadium hours before a European Champions League semi-final against Barcelona. No dead, but some injuries. The game went ahead.

A **Greek** court gave two Dutch and 12 British plane-spotters suspended sentences of between one and three years in prison for noting down details of Greek military aircraft during a holiday.

Vote of low confidence

Reuters

A referendum gave General Pervez Musharraf a further five years as president of **Pakistan**, but a low poll may have damaged his reputation. The general took power in a coup in 1999.

See article: Pakistan's referendum

As fighting spread between rival warlords in **Afghanistan**, the United States said it would attack the warlords if they threatened the country's interim government. In one clash 30 civilians were killed during a rocket attack on the eastern city of Gardez.

Many doctors in **Australia** suspended treatment for private patients after the country's largest medical insurer, United Medical Protection, faced collapse. The firm provided cover for 60% of Australia's doctors.

The Japanese prime minister, **Junichiro Koizumi**, suffered a political setback when his party lost a parliamentary by-election and a contest for a governorship.

See article: Japanese politics

Jintao's jaunt

AP

China's vice-president, Hu Jintao, remarked on his first visit to Washington, DC, that “trouble” over Taiwan could set back improvements in relations between America and China. But he pronounced his meeting with President George Bush “quite good”.

Los Angeles celebrated ten years of improvement since the riots that followed the acquittal of four policemen for beating a black suspect, Rodney King. Relations between blacks and the police were judged to be better but economic revival in the ghettos was still slow.

See article: Los Angeles ten years on from the riots

Lavagna gets a turn

Roberto Lavagna became **Argentina's** sixth economy minister in 14 months. His task is to try to clinch the IMF deal which eluded his predecessor.

See article: The tasks facing Argentina's new economy minister

In an effort to reach out to **Venezuela's** opposition, following last month's failed coup against him, President Hugo Chavez sacked his radical vice-president and promised other cabinet changes.

See article: Prospects for post-coup Venezuela

After three years of talks, **Chile** and the European Union reached agreement on a free-trade deal.

America's State Department certified that **Colombia** had made progress in human rights, freeing $62m in military aid. Human-rights groups were critical of the ruling.

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Business this week

May 2nd 2002
From The Economist print edition

Ebbing away

Bernie Ebbers, chief executive of **WorldCom**, was forced out of office. The company's fortunes and share price deflated along with the telecoms bubble. A probe of WorldCom's accounting practices by the Securities and Exchange Commission speeded the decline; questions over a $366m personal loan by WorldCom to Mr Ebbers then led to his demise. He remains as chairman emeritus.

See article: WorldCom's Bernie Ebbers goes

A merger between **Hewlett-Packard** and **Compaq Computer** at last appeared ready to go ahead, after a judge dismissed a lawsuit aimed at blocking the deal brought by Walter Hewlett, a dissident shareholder. Mr Hewlett said that he would not appeal and, more surprisingly, made a grudging undertaking to support the transaction.

Vivendi Universal's boss also had a bad week. The French media giant unveiled a write-off of goodwill to the tune of *euro*17.1 billion ($15.6 billion). Jean-Marie Messier, the group's embattled boss, alleged that hackers had interfered with voting at last week's shareholders meeting and said that the voting would be re-run.

See article: Starry chief executives fall out of favour

Hank Greenberg, ageing chairman and chief executive of **AIG**, the world's biggest insurance company, appointed two chief operating officers. The move was interpreted as a signal that Mr Greenberg, 77, has heeded the wishes of investors and engaged in a little succession planning.

Disney responded to long-standing criticism that its board lacked independence with a review aimed at better corporate governance. Critics said that the reforms did not go far enough.

Diana Brooks, once chief executive of **Sotheby's**, escaped jail for her part in a commission-fixing agreement with another auction house, Christie's. Mrs Brooks, sentenced to six months' house arrest, three years' probation and fined $350,000, got off more lightly than Sotheby's chairman, Alfred Taubman. He was sentenced to a year and a day in prison and fined $7.5m.

Expensive cars

Fiat announced an injection of *euro*1.8 billion ($1.6 billion) into its loss-making car division. Gianni Agnelli, the honorary chairman who controls about a third of the Italian company's shares, said cars were a core business.

See article: Troubled Fiat

The board of South Korea's **Hynix Semiconductor** reversed a decision to accept a $3.4 billion offer for its memory-chip business from **Micron**, an American rival, after months of negotiations. The company's state-controlled creditor banks were dismayed. Government intervention may yet follow.

See article: Takeovers in South Korea

The Czech government turned down an offer of 55 billion koruna ($1.6 billion) from an international consortium led by Deutsche Bank for its 51% stake in **Cesky Telecom**, the country's dominant telecoms

operator. The Czech's want more cash and are prepared to wait for it.

BP's profits fell by 57% in the first quarter compared with a year ago, to $1.6 billion. Recession has contributed to an intermittently weak oil price and a warm winter has depressed demand for gas.

Conflict of interests

America's Securities and Exchange Commission made good on its promise to investigate conflicts of interest at **Wall Street's investment banks**. The SEC is keen to grab back the limelight in efforts to tame the banks from Eliot Spitzer, New York state's attorney-general, who started a similar probe months ago.

See article: Bank mergers for fallen banks?

Talks broke down between **Andersen** and **Enron** investors who are suing the beleaguered accountants over its audit of the energy giant. Shareholders and creditors were at odds over the division of $300m offered by Andersen in settlement.

Talking down the dollar

The recent slide of the **dollar** was further hastened by comments from Paul O'Neill, America's treasury secretary. His commitment to a strong dollar prompted him to say that he would not mention the currency in testimony before the Senate banking committee, as he had nothing to add. But informal remarks asserting that words and deeds by government could not permanently move currencies caused the dollar to plunge.

World trade contracted by 1% in volume in 2001, after a bumper year in 2000, according to figures from the World Trade Organisation. The fragile state of the world economy was blamed. Gradual recovery should see trade grow again by around 1% in 2002.

Consumer confidence in America slipped in April, according to the Conference Board's index, suggesting that economic recovery may not be as robust as previously anticipated. But GDP grew by 5.8% in the first quarter at an annual rate.

See article: America's economic recovery

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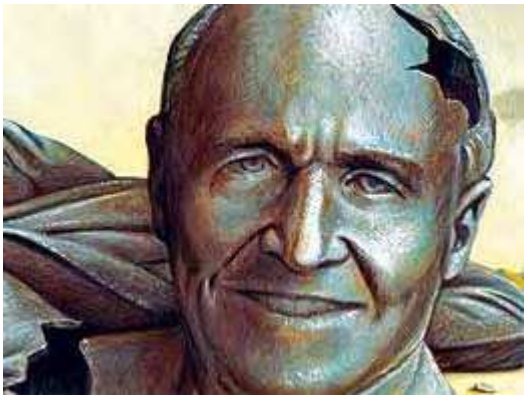
CEO's

Fallen idols

May 2nd 2002
From The Economist print edition

The world is falling out of love with celebrity chief executives

Reuters



BUSINESS leaders are being knocked off their pedestals faster than Communist heroes after the fall of the Berlin Wall. Bernie Ebbers, a deal maker from Mississippi whose creation, WorldCom, was the epitome of telecoms excitement, was forced out this week. Diana “DeDe” Brooks, a forceful former chief executive of Sotheby's, was sentenced to house arrest and narrowly missed jail—the fate handed out to her former chairman, Alfred Taubman. Even Jack Welch, the former boss of General Electric who was perhaps the best-known celebrity chief executive of all, has seen his reputation dive.

The vehemence of today's reaction against business leaders is partly a reflection of how far their companies' shares have fallen, and also of the extent of their personal greed. But it is also a reaction against the worship heaped on them in the 1990s. Revolutions devour their children, and the impact of new technology and the bull market on business was little short of a revolution. Now for the devouring.

Enron the catalyst

The cult of the all-powerful chief executive was fostered by the fact that investors found themselves lost in the maths of e-business. Company accounts, once a trusty guide, were ill-equipped to measure the strange things going on in the new economy. Investors reverted to familiar faces and seductive speeches. In their search for winners, it was easier to follow the jockeys than the form.

Disillusionment often follows when first-time investors are seduced en masse to a stockmarket, as they were in the late 1990s. It happened in Britain in the 1980s, when privatisation set out to show that equities need not be just for toffs. Naive investors then chose to follow stars—such as Anita Roddick of Body Shop and Asil Nadir of Polly Peck—without looking too closely at the numbers. Then, as now, it often ended in tears. Polly Peck, for example, went spectacularly bust.

This time the catalyst was Enron. Few understood its accounts. But they trusted Kenneth Lay and Jeffrey Skilling when they said that their company was in a totally new Internet game, a game that was going to lead to undreamed-of riches. Likewise, they loved and trusted tough Mr Welch when he produced uncannily smooth earnings growth at GE, the company Americans most admire (see article).

Once started, this process is self-perpetuating. Stars become chief executives, not the other way round. “If you were making a movie and said 'Get me a CEO' to the casting director, he'd give you Michael Armstrong,” wrote Jeffrey Garten, the dean of the Yale School of Management, in his book, “The Mind of the CEO”. Mr Armstrong had a “vision” to take an old telecoms company, in the shape of AT&T, to the heart of the new-economy revolution. The vision destroyed $140 billion of shareholder value and brought AT&T to its knees, a feat that few from central casting could ever hope to achieve.

Europe, too, is turning against its former heroes

Americans are not alone in turning against their former heroes. Europe is at it too. Jean-Marie Messier, the chauffeur's grandson who turned a French utility into Vivendi Universal, a global media empire, was once adored for having planted the French flag near the summit of Hollywood. But last week he was heckled at the company's four-hour annual meeting and is now fighting for his

business life. Lousy results, much-publicised infighting and a 40% fall in the share price this year have turned investors against him.

Then there is Percy Barnevik, a soft-spoken Swede once described by *Fortune* as “Europe's answer to Jack Welch”. Mr Barnevik was perceived as having single-handedly turned ABB into Europe's greatest transnational corporation. But that was before ABB announced massive losses last year and disclosed retirement benefits of $136m arranged by Mr Barnevik for himself and his successor. The erstwhile hero is now being vilified for his greed.

Yet nowhere raises their corporate heroes as high as America; and nowhere are they knocked down so low. The hero worship has this time been vastly encouraged by the growth of new media. A new breed of television channel devoted to business and finance—CNBC, Bloomberg and CNN Money—needed faces to put on their screens. And there were new business magazines with covers to fill. “Mugs sell mags” is a tenet of cover designers, and the likes of Jack Welch, Jeff Bezos, Larry Ellison and even Bernie Ebbers were favourite fillers. One piece of research actually found a correlation between the number of times that chief executives appeared on magazine covers and the excessive amount they had paid for their acquisitions. Call it the cost of hubris.

It took Enron's demise to shatter completely investors' illusion that backing the jockeys was a good idea. The greed and deceit of its bosses have tarred everybody. Mr Welch is now widely portrayed not as a star chief executive but as an ageing philanderer; business journalists in America yearn to be the first to reveal the accounting tricks that made GE's earnings levitate for so long.

A call to account

Now that they no longer trust the man, investors (and others) need to put more faith in the figures. It is for those who set accounting standards the world over to ensure that the numbers improve (see article). That will involve at least three things. Investors must learn to live with figures that are more volatile, but more truly reflect the shifting risks of the real world. Accounts should become less focused on a single “bottom line” number, such as “profits”. When undue attention is focused on a single figure, undue effort is devoted to manipulating it. Finally, there needs to be a return to the practice whereby accounts (always to some extent subjective) are judged “fair” by an independent and trustworthy outsider.

Academics and consultants are trying to prove that modest, unassuming folk are the ideal chief executives for the 21st century. But big business today has too much in common with show business. When there are no stars, they tend to be created. By all means tear the statues down, but don't destroy them. The faces can be rechiselled next time round.

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Anti-Semitism

Europe and the Jews

May 2nd 2002
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Is anti-Semitism surging back?

Get article background

AP

IN THE months since September 11th, Europe has seen an increase in attacks on synagogues and other Jewish centres, a rise in threats and intimidation directed at individual Jews, and an increase in anti-Jewish propaganda of one sort or another. On April 21st, Jean-Marie Le Pen, the blithely anti-Semitic leader of the far-right National Front, gained second place in the first round of the French presidential election—a remarkable victory, however bad a drubbing he gets in Sunday's second round. In Germany armed police guard Jewish schools, and Jews are advised not to wear visible signs of their faith. In Britain, often praised for its tolerance, a synagogue was attacked and desecrated this very week.

This great new surge of European anti-Semitism—if that is what these events signify—solves a puzzle that has been taxing a lot of Americans. Israel is a victim of terrorism, much as America was a victim of terrorism in September. Israel is defending itself against pitiless murderers with all available means, much as America is defending itself. Right and wrong in the matter, or so most Americans believe, could hardly be clearer. Why, then, Americans ask, is Europe taking the side of Palestine's suicide bombers, passing lightly over their crimes, while vilifying Israel's government for its restrained (under the circumstances) assault on the terrorist infrastructure of the West Bank? These perverted sympathies seem quite inexplicable—unless the answer, albeit painful to contemplate, is obvious. Anti-Semitism, it is argued, explains it all.

This account of European attitudes seems to be catching on in the United States. In a not unrepresentative column in the *Washington Post*, Charles Krauthammer, one of the *Post*'s most distinguished political commentators, wrote this:

“What we are seeing [in Europe] is pent-up anti-Semitism, the release--with Israel as the trigger--of a millennium-old urge that powerfully infected and shaped European history. What is odd is not the anti-Semitism of today but its relative absence during the past half-century. That was the historical anomaly. Holocaust shame kept the demon corked for that half-century. But now the atonement is passed. The genie is out again.

This time, however, it is more sophisticated. It is not a blanket hatred of Jews. Jews can be tolerated, even accepted, but they must know their place. Jews are fine so long as they are powerless, passive and picturesque. What is intolerable is Jewish assertiveness, the Jewish refusal to accept victimhood. And nothing so embodies that as the Jewish state.”

Is the supposed release of Europe's loathing of the assertive Jew a good explanation, in fact, of the gulf over Israel that divides the United States from its European allies? Sadly, recent events have lent the idea plausibility. It is nonetheless wrong—a gross distortion and a terrible slander.

The enormity of the Holocaust ought to have eradicated anti-Semitism for all time. Shamefully, it did not. In much of the world, hatred of Jews thrives. In particular, newspapers and broadcasters across most of the Arab world deal routinely in repellent expressions of loathing of Jews and their faith. Elsewhere in the world—in Europe and, it should not be forgotten, also in the United

Is the supposed release of Europe's loathing of the assertive

States—anti-Semitism also survives, most visibly in a fringe of neo-Nazis and other despised outcasts, but also, and somewhat more widely, in milder forms of prejudice and suspicion. Still, impossible as it may be to measure people's private feelings, the great majority of Europeans, it seems to us, harbour no suppressed anti-Semitic hatred. On the contrary, they sincerely deplore anti-Semitism, so much so that Mr Krauthammer's portrait of Europe's secret heart will strike many as a shocking insult. In most of Europe, to call somebody anti-Semitic is one of the worst accusations you can make. It is not one to be made lightly.

Jew a good explanation of the gulf over Israel that divides the United States from its European allies? It is not

But recent events in Europe—the attacks on synagogues, the success of Mr Le Pen—give the lie to that reply, do they not? Alarming and deplorable as they are, the answer is no. These events do not show that anti-Semitism is broadening its base (see article). Anti-Semitism has lately been more apparent in France than elsewhere in Europe: even there, Mr Le Pen found it opportune this time to soft-pedal the anti-Jewish prejudice, calculating that it made better sense to denounce attacks on Jews in order to stir up hatred of Muslim immigrants. It suited Mr Le Pen in this election actually to pose as a defender of French Jews against their Muslim enemies and against immigrants in general—an odd way to call on brimming reserves of anti-Jewish hatred, waiting these past 60 years to overflow.

An Israel beyond criticism?

It is important to understand that in most of Europe—as in America—anti-Semitism is a prejudice of a small minority, not the mainstream. A quite separate point is that criticism of Israel, let alone criticism of its government, need not be motivated by hatred of Jews. In their support for Ariel Sharon, Americans have often seemed more united than Israelis. Israelis who feel that Mr Sharon is wrong to resist a settlement with the Palestinians are presumably not guided in that belief by anti-Semitism, not even of the disguised or pent-up kind. This is not to deny that some outside criticism of Israel and its policies is indeed partly fuelled by anti-Semitism. (Where that is true, as in the claims of many Arab governments and commentators, and in many of Europe's Muslim communities, it should be recognised and repudiated.) It is only to say what should be obvious but apparently isn't: that it is not anti-Semitic *per se* to criticise Mr Sharon.

Europeans have in fact become readier to criticise Israeli policies in recent years. The guilt that people who lived through the 1930s and 1940s felt about their failure to prevent the Holocaust is not felt to the same degree by the post-war generation. The goodwill that attended the birth and early years of Israel, which extended to admiration and active support during the 1950s, 1960s and 1970s (so much for Europe's loathing of Jews who stick up for themselves) has since waned. Criticism of Israel that would once have been bitten back is now being freely expressed. In the same way, and this is to be regretted, the zeal of Europe's rejection of Jewish hatred—its anti-anti-Semitism—may have faded somewhat too, especially on the left. In both these ways, Mr Krauthammer's point about declining Holocaust shame has a semblance of validity. These developments are new, as he says—but they are not the same thing as a resurgence of anti-Semitism.

Whether Europe's objections to Mr Sharon's policies are sound is another question altogether. In recent weeks we have discussed this at length, agreeing with his critics in some respects, disagreeing with them in others (notably, by affirming Israel's right to defend itself against murderous terrorists). A more strongly critical line than the one we have taken on Mr Sharon would be mistaken, in our view; but it could very easily be wrong, or foolish, or cowardly, or immoral, without being anti-Semitic. For the sake of clearer thinking about the Middle East—and in the interests of a close Atlantic alliance, which, for all its difficulties, is worth defending (see leader)—Mr Krauthammer and those who agree with him need to understand this.

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America, Europe and NATO

Stay together, fight together

May 2nd 2002
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NATO has changed a lot. Now it needs to change more

TO PUT it bluntly, if NATO, the military arm of the transatlantic alliance, had not existed in the post-September 11th world, would anyone be seeking to invent it? Not in its present form, it has to be said. But though the dangers facing Americans and Europeans have changed, the need for collective defence against them has not. The next terrorist attack could strike Berlin or Paris as easily as New York or Washington. These and other threats, in an age of far-flying missiles, could come from anywhere. So NATO needs to be better prepared to deal with them, ready at times to venture beyond its European stomping grounds. In other words, if it is to soldier on usefully, the alliance needs to reinvent itself. The new design is needed by its next summit, in Prague in November.

NATO has changed a lot since the end of the cold war, but the world has changed faster. Later this month, alliance foreign ministers will start the debate about its future, and will also invite Russia, their old cold-war enemy, to join its discussions on some matters of common concern. Russia has long thought NATO should do more talking than soldiering. That is not what the foreign ministers are going to say they intend. They want a militarily more capable NATO. Willing the end is one thing, willing the means quite another (see article).

Nay-sayers cite America's impatience with NATO-led peacekeeping duty in the Balkans and its frustration with war-by-committee in Kosovo. Now that America sees terrorism and weapons of mass destruction as the chief threats to its security, Europe's lack of high-tech weaponry and its inability to get troops quickly to faraway battles hobbles the alliance. America's unrivalled military power meant it could choose—indeed preferred—to take on al-Qaeda and the Taliban in Afghanistan mostly alone. Meanwhile, the Bush administration's determination to confront Saddam Hussein has attracted little overt allied support, except from Britain. Some Europeans would be happy to take the Balkans and let America deal with the rest.

The flaws in this ought to be most obvious in Europe. Even with the formation of a 60,000-strong EU-sponsored rapid-reaction force (promised for next year but unlikely to be ready), Europeans would be woefully ill-equipped to march off on their own. Indeed the EU force was conceived of by Britain to get the Europeans both to pull more weight in NATO and, in the process, to win more say in how it is run. More must be done and more quickly to find the mobile, readily deployable forces NATO needs, and the ships and aircraft to move them. The Europeans need not do everything that America does, but one way or another they all need to be ready to do their bit—and pay for it. Spending their defence budgets more wisely, pooling this and bolting together that, can help. But in the end more capability will cost more too.

It is not enough, of course, for the Europeans to want NATO to thrive. America must want it too. Inevitably, as the battle lines have moved from the heart of Europe to its horizons and beyond, militarily the alliance no longer seems all-important to America. Yet it is far from useless. Those who fault NATO for not running more of the war in Afghanistan forget that America did not call on it to run the Gulf war either. But in these two very different campaigns it was NATO's planning and joint training that gave America the ability to call on its allies' soldiers and skills when it needed them. Lose that capability, and even mighty America would notice.

Not just a geographical expression

But NATO is not just a handy military tool. In Kosovo, it mattered a lot that it was not just the world's most powerful country but 19 of its most respected democracies that stood firm against the marauding Serb army. NATO won the military campaign in 78 days, with remarkably few casualties even among the enemy; its collective moral weight also helped turn the political tide in Serbia against Slobodan Milosevic—and forced others, including Russia, to think hard about where they stood in Europe. As the debate over how to deal with Iraq shows, forging an alliance consensus will not always be easy, but it is very much worth the effort.

If NATO is to remain effective, it needs to think harder about what holds it together: its integrated military structure and its mutual defence guarantee. Stretch these too far and it will unravel. Before September 11th America was inclined to scoop in as many new recruits as possible at Prague: Slovenia, Slovakia, the three Baltic states, Bulgaria and Romania are all mentioned. But if it is to take on new tasks, NATO needs newcomers with real capabilities. By November, some of the would-be-ins will measure up, and some will not. Bringing them all in willy-nilly would weaken the alliance.

NATO's future will be what its members choose to make it. Unless Americans and Europeans can agree that it has useful jobs to do—and then take the hard decisions on new capabilities and members—the world's most successful military alliance might soon call it a day.

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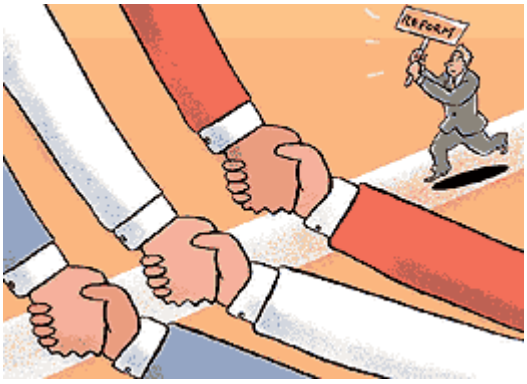
The Netherlands

Going Dutch

May 2nd 2002
From The Economist print edition

The country's success owes more to pragmatic policies than cosy consensus



THE focus in Europe is on the rowdy tumult in France, where Jacques Chirac faces the far-right Jean-Marie Le Pen in the second round of a messy presidential election on May 5th. But just to the north, in the usually quiet and tidy Netherlands, another messy election looms ten days later—with another far-right candidate, Pim Fortuyn, expected to do well. It is tempting to note a straightforward connection, since both are campaigning on an anti-immigrant platform; but Mr Fortuyn, who is openly gay, disavows Mr Le Pen's racism. The true link between the two is more subtle.

Over the past two decades, the Netherlands has done considerably better than France. Indeed, it boasts one of the best-performing economies in Europe, with relatively rapid growth and one of the highest employment rates in the OECD. The Dutch have also become famous for sensible social policies, whether it is toleration of soft drugs, legalisation of euthanasia or trying out competition in health care. Most of these work, as well: for instance, cannabis use is falling among schoolchildren despite its easy availability in “coffee shops”, and the country long had the world's lowest abortion rate even though it was one of the first places to legalise it.

Such success has fostered much interest in the Dutch “polder model”, short-hand for the system of policymaking by consensus among interested parties, and especially between employers and employees. The polder model, it is often said, demonstrates that economies can grow and jobs can be created without dismantling the rigid and overly generous European social-welfare system. Similarly, it is argued that consensus policies, agreed across the political spectrum (coalition government is inherent in the Dutch electoral system), are the best way of dealing with social problems.

Our survey of the Netherlands in this week's issue assesses these claims and reaches two main conclusions. The first is that the Dutch have indeed done well, both economically and in tackling some of the more vexing social issues. But the second is that this success had little to do either with the polder model or with consensus-building. The strength of the Dutch economy in the 1990s is attributable mainly to sound fiscal and monetary policies, to an exchange rate that gave the country a competitive edge over Germany and to a few liberalising measures that were pushed through amid much controversy. In social policies, the story is as much of a pragmatic willingness to experiment as of doing things by agreement. Worse, it is the very need for consensus that has inhibited further reforms to the much-abused and excessively generous disability system, which pays out to a ludicrous one in seven Dutch people of working age.

When conflict is needed

The real lesson for the rest of Europe from the Netherlands is not about consensus but about the need for tough decisions to overhaul public services and welfare systems and to liberalise economies. And this brings the debate back to Messrs Fortuyn and Le Pen. Some of their success reflects a base appeal to anti-foreign feeling. But much stems also from a populist dissatisfaction with the established political leaders, who are too fond of the same old policies, too timid to tackle tough social and economic problems and too distant from voters' concerns. In this sense, the emergence of the far right should be treated as a warning: a cosy consensus is not enough.

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Central Asia

Stopping the rot

May 2nd 2002
From The Economist print edition

Democracy and the sport of geopolitics

Reuters

ON HIS tour this week of Central Asia, Donald Rumsfeld, America's defence secretary, thanked the region's leaders warmly for their contribution to the war in Afghanistan. They had opened up their roads, railways, air corridors and military bases. And they had been only too happy to help. The Taliban and the armed Islamists they spawned had menaced each one of these fragile new states. Yet fostering new military relationships, important as these are, should not be the only aim of western policy. Development and better government are needed too.

Kazakhstan, for example, looks set to become one of the world's top oil producers. Yet evidence from other places suggests that oil money can badly distort an economy as it travels the short distance between western buyers and the offshore bank accounts of cynical rulers. Outsiders can help guard against that danger by keeping up pressure in these former outposts of Soviet rule for more open societies, where the strains of wrenching change can be absorbed by a healthy degree of press freedom and political debate.

Instead, in Kazakhstan and in Kirgizstan, the two most committed until recently to market economics and multi-party democracy, there have been arbitrary arrests and a crackdown on the independent media (see article). Meanwhile Uzbekistan, which aspires to be the regional cop, has always had an authoritarian tinge. No bad thing, some outsiders would say, when there are unruly borders to guard and a real threat from Islamist extremists. But leaders in all three places have clearly taken their new-found strategic importance as an opportunity to turn the screws on dissenters.

Meanwhile Tajikistan and Turkmenistan offer cautionary tales of the trouble that could infect the whole area if the outside world turns a blind eye. For most of its first decade of independence, Tajikistan was mired in a drug-fuelled civil war that still has disastrous effects: Tajiks play a key role in transporting Afghan heroin to Europe. In Turkmenistan, a sterile personality cult has fostered poverty and human-rights abuses; the country at one point flirted with the Taliban, and has failed to exploit or market its huge gas reserves effectively.

Western governments should not shrug off Central Asia's creeping authoritarianism

Tempting as it might sometimes seem for western governments to shrug off Central Asia's creeping authoritarianism as a price worth paying in the bigger geopolitical and financial game, that would be short-sighted—for pragmatic reasons as well as for moral ones. Tyrannies with unhappy subjects are unlikely to be reliable economic or strategic partners. Where people conclude—as some already have—that America and its allies care about nothing except oil revenues and military bases, the West can come to seem the source of their travails, and they become easy converts to extremism. Once anti-western sentiment has taken hold, it can then be cynically exploited by local despots (even those with cosy relationships with the West) to distract attention from their own misdeeds.

What can western governments do? They cannot turn the region's leaders into paragons of democracy. Heavy-handed pressure, applied to tough rulers still jealous of their newly-won independence, can be counter-productive.

Western governments would do better to give a helping hand to those courageous individuals who are working to keep the flame of independent thought flickering. Often the best deliverers of such help are

not embassies or visiting politicians, but non-governmental agencies. Tiny amounts of money—a printing press here, an internet-linked computer there—can make the difference between survival or extinction for a local party or lobby group.

Encouragement where it counts

To advocates of cold realism in foreign policy, such concerns may smack of sentimentalism. As long as Central Asia's rulers open their airfields to western military planes and their oilfields to western corporations, does it matter very much if they lock up their rivals or use electrodes on their dissidents?

Such arguments were once used to justify America's unconditional support for the monarchy in Iran. When opposition there finally burst into the open, it was not inspired by western models but was driven by anti-western rage. These days technology makes it even harder to maintain repressive regimes and stamp down dissent. Ideas cross frontiers more easily, no matter how hard tyrants try to prevent this. Another good reason for western governments not to collude with creeping authoritarianism in Central Asia, but to use their influence to stop the rot.

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Airline miles

Frequent-flyer economics

May 2nd 2002
From The Economist print edition

One of the world's main currencies is heading for a fall

Get article background

THE world has a new international currency: frequent-flyer miles. Launched exactly 21 years ago, they are a lot like money. Collectors check their mileage statements as keenly as their bank statements. American courts often place a value on mileage balances in the course of divorce settlements. In a recent poll of frequent travellers, two-thirds said that they see frequent-flyer miles as the next best thing to actual cash: almost half even thought they should earn interest on their accounts. Will they still be as keen a year from now? Maybe not. This peculiar new currency has not been well-managed. Devaluation is on the cards.

Frequent-flyer miles started as a marketing gimmick, but they have become a lucrative business. Airlines sell miles to partners, such as credit-card companies and car-rental agencies. Roughly half of all miles are now earned on the ground, not in the air. This makes them ever easier to acquire. At the end of April, the worldwide stock of unredeemed miles was probably close to 8.5 trillion (see article). Miles can be worth anywhere between two and nine cents apiece when they are used to buy an air ticket. Valued at the mid-point of this range, the total global stock of frequent-flyer miles may now be worth almost $500 billion.

Comparing this with all the notes and coins in circulation around the globe, frequent-flyer miles could be said to be the world's second-biggest currency after the dollar. Indeed, at its present pace of growth the stock of miles is likely to overtake the physical stock of dollars within two years. Of course this ignores the much bigger stock of dollars sitting in bank accounts. But frequent-flyers care more about liquidity—preferably a glass of champagne after take-off—than about the precise differences between M0, M1 and M3.

Miles outstanding have risen by an average of 20% a year since 1995—two-and-a-half times as fast as the supply of dollars. Central bankers would suffer sleepless nights at such reckless monetary expansion were it not for the fact that they are usually up in first class collecting double or triple miles. The plain truth is that airlines have been printing too much of their currency. They are issuing more miles than they can ever supply in free seats. (Only a small fraction of miles are used to buy other goods and services.) As any first-year economics student knows, excessive monetary growth can lead to hyperinflation and devaluation.

The airlines will be all right. The small print allows them to restrict seat availability and to change the rules of their schemes at will. Inflation hurts the mugs left holding the currency. Either airlines will increase the number of miles required for a free flight (not for the first time), or travellers will find that booking the flight of their choice becomes even harder than it is already. Both are a form of devaluation. Spend them while you can.

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Local government and central power

Follow the money

May 2nd 2002
From The Economist print edition

People don't vote in Britain's local-government elections, because there's no point. Until the government gives up some fiscal power, its constitutional reforms will remain empty

TONY BLAIR has always seen himself as a radical, but the past five years do not support his self-image. His government's greatest achievement has been sound macroeconomic management, not mould-breaking change.

Challenged for evidence of radicalism, Mr Blair's supporters invariably point to constitutional reform—parliaments in Scotland and Wales; mayors in London and other cities; a White Paper this month proposing regional assemblies for England. Surely all this adds up to radical devolution?

No, it doesn't. Proliferating elections and grand new parliament buildings are not the real stuff of devolution. What really matters is power over money; and, by that measure, Britain is more centralised than ever.

The origins of this government's centralising tendencies are perfectly honourable. When it came to power in 1997, it made much of the need to work out whether taxpayers were getting value for their money. Past governments tended to look only at inputs—how much money was going into hospitals or schools. This government would also measure outputs—what sort of service was being delivered.

This is a fine principle, loosely applied; but it has been translated into thousands of targets governing the lives of people working in distant branches of government. That applies to local as much as to central government, because local government's independence has long been a fiction. Since councils receive three-quarters of their cash from central government they are, in effect, agents of central government.

After the Trots

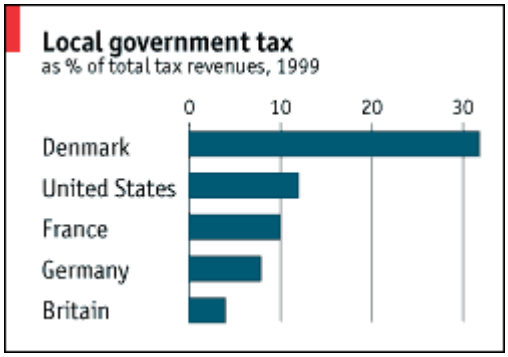
Mention of local government arouses yawns and derision these days. This is a sad state of affairs for an institution which brought water supplies, sewerage, street lighting, electricity, gas, trams, public baths and health services to Britain's cities after the industrial revolution. Local, not central, government was responsible for the fall in infant mortality from nearly 160 deaths per 1,000 births in 1850 to just over 20 in 1950.

Socialism and Thatcherism killed local government. The first demanded equality of access to public services, so Whitehall assumed responsibility for ensuring that a child got the same standard of education in Teesside and Tonbridge Wells. The less power the councils had, the sillier they became. By the time Margaret Thatcher came to office, several of Britain's big cities were run by stary-eyed Trots (some of whom are now in government) shovelling ratepayers' money to lesbian encounter groups. She capped their spending and took away most of their tax-raising powers, which made them more impotent, and sillier, than ever.

Councillors thought 1997 had brought a new dawn. Their optimism soon wore off as their freedom was further constrained by a regime of inspectors, auditors and performance indicators which ensured that any new scheme had to be signed off by a row of Whitehall bureaucrats.

So it is that, after 50 years of centralisation, Britain is, according

to Tony Travers, an academic at the London School of Economics and the country's leading expert on local government, “one of the most centralised democracies in the world”. Some 96% of all tax revenue goes straight to the Treasury, a higher proportion than in almost any other rich country.



That is why people don't bother to vote. Council tax bills—the average bill is £804 a year, around the same as the average couple spends in restaurants—do not reflect the cost of local services. If the tax bill reflected what local government spends—roughly four times as much as it raises, or 15% of total government spending—then voters might pay rather more attention to who they were electing.

As it is, Whitehall's stranglehold fosters the kind of dependency among councils that government struggles to discourage among individuals. Since 75% of local government's revenues come as a direct hand-out from central government, there is little relationship between effort and reward. An efficient council can reduce waste and find that it has even less money to spend because Whitehall has cut its stipend. An inefficient council can waste more money and find that it has even more to spend because Whitehall decrees it.

Give it up, Tony

So why, given how much damage has been done by taking power away from councils, won't the government give some of it back? For a combination of reasons, probably. The worst is that governments do not like giving up power once they have it. Another is that local government is too badly run to be given more responsibility. But that doesn't wash. Many cities are tolerably well run, these days, largely because most of the Trots were turfed out in favour of perfectly sensible Liberal Democrats, who see local government as their principal power base and so put a lot of effort into doing it right. Anyway, the reason why local government was not as well run as it should have been is that it was deprived of power. Keeping it impotent will perpetuate the problem.

A better argument is that more devolution means less equalisation, so the rich will get richer and the poor poorer. Yet a rise in inequality is not inevitable. Giving councils greater freedom to set taxes would, for instance, allow them to compete to attract business, in the way that the administrations of deadbeat American cities such as Detroit and Cleveland did successfully. That may in part explain why, on the European mainland, local government has, in most places, more autonomy than in Britain, yet less regional inequality.

Handing power back to local government might make things work better for politicians, as well as for people. During the last general election campaign, there was a moment that said a lot about how Britain is run. On a walkabout in a hospital, Mr Blair was buttonholed by the partner of a man who was waiting for a bone-marrow transplant. Why did he not do something about it? Mr Blair was visibly flustered. Being held responsible for every trolley stuck in every hospital corridor in Britain has its downside. Power is a fine thing, but a man can have too much of it.

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Letters

May 2nd 2002
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

The French disease

SIR – A better cover photograph than Jean-Marie Le Pen's to illustrate your article on his surprising success in the French presidential election would have been a collective portrait of the entire French political leadership, left and right, that misgoverned France into this mishap in the first place ("France's shame", April 27th).

France's ruling caste has simply become so incestuous, in-bred and mandarin that it is now hermetically sealed against new ideas. The overwhelming political, educational and intellectual dominance of the Paris-based elite has led the French into a cul-de-sac. France's stifling, rote-based educational system, ludicrously topped by an Ecole Nationale d'Administration (ENA) specialised in churning out fine-tuned intellectual prostitutes, has decisively failed to ensure that the sharpest and most creative talent of France is identified and promoted. Instead, a new generation enters the governmental arena already sucked dry of creativity and drive.

Andrew Erickson
Geneva

Sao Paulo's air viewed

SIR – It is not true that "Sao Paulo has scarcely begun to act" to mitigate air pollution ("The right to drive or the right to breathe?", March 9th). The Environmental Agency for the State of Sao Paulo (CETESB) co-ordinates emissions-control programmes at national level. We will soon start annual emissions testing for the whole vehicle fleet.

As you say, all gasoline used in the country is blended with 24% of ethanol from sugarcane, a renewable fuel which is less toxic than fossil fuels. This has cut carbon-monoxide, hydrocarbons and sulphur emissions. Leaded gasoline was completely banned in 1991. Lead ambient concentrations in Sao Paulo's metropolitan region have fallen very sharply. Contrary to what you say, CETESB also monitors ambient concentrations of aldehydes in Sao Paulo and they are below the reference levels found in the literature.

In spite of all these efforts, particulate matter and ozone concentrations in Sao Paulo remain high. But Sao Paulo has 7m vehicles; twice as many as Mexico city. The state environment secretary is working on a sustainable-transport policy.

Ana Paula Fava
CETESB
Sao Paulo

Hong Kong's security

SIR – You make reference to Harry Wu and a conference organised by Falun Gong members ("One country, two systems", April 20th) and allege that the Hong Kong Special Administrative Region (HKSAR) government has "seemed suitably eager to accommodate China's sensitivities at its passport controls." This is a far cry from the truth.

Under the Basic Law, immigration is entirely a matter for the HKSAR government. We acted within our

immigration autonomy and suggestions that refused-landing decisions are made at the behest of Beijing are offensive and unfair. Effective immigration control is essential to safeguard the security of our community, as well as foreign visitors and businessmen staying in Hong Kong. While the director of immigration is empowered to refuse entry under our immigration ordinance, he acts reasonably and in good faith, taking into account the prevailing circumstances relevant to a particular case. As always, he acts within the law. Nearly 13.8m visitors, twice our population, come to Hong Kong every year. As one of the freest jurisdictions in the world, our door is wide open to all bona fide travellers from all continents. Like everybody else, we have the right to refuse entry where it is in our interests to do so.

You also allege that Hong Kong is "putting up little resistance to pressure from China for an amendment to Hong Kong's constitution—Article 23, now in draft form—which would outlaw all sorts of activities as 'subversive' to the motherland." This talk is as garbled as it is alarmist. First, rather than extending its own subversion laws to the HKSAR, the central government has left it to the Hong Kong government to enact its own laws. This is part of the "one country, two systems" arrangements. Second, we see no reason why Hong Kong should not have laws on national security like all other countries or territories, nor why such laws should harm individual rights and liberties. Third, the enactment of local legislation to implement article 23 of the Basic Law (BL23), which deals primarily with national security, will not entail amendment to Hong Kong's constitution. Fourth, there is no firm timetable for legislation and no question of a draft bill on BL23 at present. When our proposals on implementing BL23 are ready, we will consult the public widely and any final proposal adopted will have to be endorsed by our legislature.

Regina Ip
Secretary for security, HKSAR
Hong Kong

Cavallo defended

SIR – Those who understand the propensity in Argentina for dispensing with political adversaries through the judicial process know that Domingo Cavallo is innocent of the charges against him ("Enter the scapegoat", April 13th). Mr Cavallo has suffered judicial harassment since 1996 as political adversaries have sought to influence the legal system in order to silence him. The same judge who declared last September that he could find no evidence to convict Mr Cavallo, suddenly detained him without any new evidence.

Mr Cavallo had no reason to believe that arms shipments were going to be rerouted. The decree that Mr Cavallo signed as economy minister relating to the arms shipments over which he has been accused was no different in language to any of the other 20 such decrees signed by other economy ministers since the restoration of democracy in 1983. Mr Cavallo has a reputation for fighting corruption and when allegations were raised about the shipments he demanded that the decrees be made public record. Mr Cavallo has nothing to hide and, sooner or later, he will be cleared of this matter.

Alfredo Castanon
Lawyer to Domingo Cavallo
Buenos Aires

Venezuela's coup

SIR – Regarding the recent coup in Venezuela, you state that, "two individuals, however, have connections with both the White House and the coup," and claim that one "is Lou Giusti, a former head of Venezuela's state oil company. He has ties with the White House as an energy adviser...Mr Giusti's political allies backed the coup" ("Tales from a failed coup", April 27th) In order to set the record straight, I have neither any ties with the White House nor any connection whatsoever with those who staged the coup.

Luis Giusti
Washington, DC

Heavings above

SIR – Have those who propose a "blended-wing-body aircraft" looked at a large jet as it manoeuvres after take-off or before landing on a gusty day? Anyone willing to fly in wing-tip seats may have to pay a "big dipper" premium to cover the extra costs of sick-bags and cleaning, thus partly offsetting the "killer attraction" of low operating costs.

Nick Riley
Broadstairs, Kent

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The future of NATO

A moment of truth

May 2nd 2002 | WASHINGTON, DC
From The Economist print edition

The NATO alliance has until its November summit in Prague to decide what it is for

Get article background

NOBODY damns NATO with faint praise. Both boosters and detractors call it the most successful military alliance in history. But does it have a future? It is hard for Americans and Europeans to imagine the past 50 years without the North Atlantic Treaty Organisation there to defend them. Yet it is harder than it used to be to imagine NATO, as it is, advancing far into the 21st century.

Before September 11th, the question dangling over the transatlantic alliance was what it was for. The cold war, after all, had been over for ten years. Since the attacks on the United States, and with Europe, too, more worried than it used to be about unfettered terrorism and the spread of weapons of mass destruction, the value of “collective defence” is no longer in so much doubt. But does America, with its unrivalled military power, need NATO any more? And, assuming someone wants and needs it, how can the alliance be adapted to defend its members against the very different threats they now face? If good answers are not found before the NATO summit in Prague in November, the future of NATO looks bleak indeed.

NATO has never been busier, but not due to the collective-defence duties for which it was created

By an irony, NATO has never been busier. But much of its recent activity has been in fuzzier collective security—organising peacekeeping missions, holding the hands of Europe's weaker new democracies—rather than the harder-edged collective defence for which it was created. You might call it, as some do, babysitting the end of the cold war. Not everyone is unhappy at this change. Peacekeeping in the Balkans and elsewhere, as those who do it sharply point out, is not for wimps. Others, on both sides of the Atlantic, argue that ensuring peace and stability in Europe, given the trouble its past wars have caused, is anyway plenty for NATO to be getting on with. But those who want NATO to be doing more than babysitting are in deeply gloomy mood.

NATO troops still turn out together for peacekeeping duty in the Balkans, though in smaller numbers now. But what the war for Kosovo revealed, and the American-led campaign in Afghanistan hammered home, is how far the European members of NATO lag behind America, both in high-tech weapons and in their ability to get useable troops speedily to where they are needed. The extra $48 billion that President George Bush now proposes to add to America's $331 billion defence budget is more than Britain or France spends on defence in a year. As Europeans struggle to equip the 60,000-strong EU-led rapid-reaction force they promised for next year, such a gap may well drive them to despair.

Even success can be a problem. Former cold-war adversaries from Central and Eastern Europe are either in NATO already (Poland, Hungary and the Czech Republic) or else queuing to join, with Russia's president keen to get alongside. Last June, in Warsaw, Mr Bush called on NATO to be ready at Prague to issue as many new invitations as possible. The alliance should “not calculate how little we can get away with, but how much we can do to advance the cause of freedom.” Yet some of those who most value NATO's military effectiveness—the British and German governments, some members of the United States Senate—have doubts about going much beyond the current 19 members. They worry that Mr Bush's open-door enthusiasm really reflects his dwindling interest in NATO as a military tool.

Critics feel that to extend new invitations to Slovenia, Slovakia, perhaps the three Baltic states of Estonia, Latvia and Lithuania, and possibly even Bulgaria and Romania, would inevitably dilute the alliance, turning it into more of a security talking-shop. That might make a bigger NATO more acceptable to Russia, but would reduce it to little more than an armed version of the Organisation for Security and Co-operation in Europe, which is open to all Europeans and spends its time on good works such as election-monitoring.

Such worries have been compounded by America's swift, crushing and mostly unilateral military response to the September 11th attacks. Although the alliance, for the first time in its history, formally invoked Article 5 of its treaty and thereby declared the attacks on America to be an attack on all, European governments fret that America's military chiefs—compelled by the need for speed, but also with the frustrations of warfare-by-coalition in Kosovo in mind—preferred to fight al-Qaeda and the Taliban regime in Afghanistan largely on their own.

Where European officials tend to be gloomy, however, senior officials in the Bush administration see mostly NATO's opportunities. One recalls that, as he sat in the White House in the wake of the September attacks, NATO's swift invocation of Article 5 came as “an expression of European solidarity none of us will forget.” Another admits that September 11th was a “wake-up call” for the alliance, but in its aftermath, he argues, “NATO's stock has never been higher.” The challenge now is to make the alliance more effective against the new threats.

Thinking positive

It is true that the eventual fighting in Afghanistan was not a formal NATO operation. But at both the Pentagon and the State Department this matters much less than the fact that every NATO member (and would-be member) is somehow involved. All but a couple have soldiers doing dangerous jobs on the ground, whether helping to flush al-Qaeda members from their caves or manning the international security force that is currently stationed in and around Kabul. Nor is the war in Afghanistan necessarily a good case-study for the future. The adversary in this instance was poorly armed, only a few specialised ground troops were needed early on, and there were local groups to work with. America may not be the next target of attack, officials point out. And future military operations may need to be conducted differently.

America's changed thinking about NATO after September 11th is already reflected in its new priorities for the November summit. First, say Mr Bush's officials, will come discussion of new capabilities against the new threats. Only then will come discussion of new members, and after that new relationships. This last means chiefly the effort being launched this month to include Russia as a partner with NATO's 19 members in deliberations on common problems (which would then be held “at 20”), but also includes relations with Ukraine, Central Asia and others.

Since threats to NATO members can come unexpectedly, from anywhere, NATO needs to be ready for anything. Weapons of mass destruction in the hands of bad guys, insist American officials, present as much of an “existential” threat (that is, a threat to everyone's existence) as the Warsaw Pact divisions once poised to pour through the Fulda Gap. Britain's Tony Blair publicly endorses that view. So, by their quieter actions, do many other European governments, from Norway to Spain. “Long-range ballistic missiles pay no heed to national borders,” argued Germany's defence minister, Rudolf Scharping, recently at the International Institute for Strategic Studies in London. NATO must be ready to act where its vital security interests are at stake, whether in Europe “or some other corner of the world”.

That is the challenge, and it has implications for all aspects of the Prague summit agenda. Can NATO meet it?

With allies like these...

Long before the events of September 11th, NATO's secretary-general, Lord Robertson, was telling everyone who would listen that the alliance's future depended on “capabilities, capabilities, capabilities.” Yet not only NATO, through its defence-capabilities initiative launched in 1999, but also the EU, with the goal it has set for its rapid-reaction force, have promised more than European governments have delivered. Sharp declines in defence spending have levelled off, and 11 of the EU's 15 members are now planning small increases. Yet this is not enough to fulfil Mr Blair's hopes, as he launched the EU's defence effort along with France, that Europeans would do more under an EU label for the ultimate benefit of NATO.

These meagre efforts are recognised in defence ministries across NATO as the greatest threat to the ability of Americans and Europeans to sustain NATO as a military alliance. It is not that the Europeans do nothing: between them they provide more than 65% of Balkan peacekeepers and do a lot of other handy things. But the few useable forces they can muster from the more than 2m men and women they have under arms are already overstretched.

Part of the answer to Europe's capability shortage, suggest American officials, is to refocus NATO's 58 capability goals on the things that are most needed in the post-September 11th world: compatible and secure communications, air- and sea-lift, special-operations forces, precision-guided munitions and the ability to fight together under threat of the use of nuclear, chemical or biological weapons. Ships and aircraft are expensive; the right radios and gas-masks are not.

Nor need everyone gear up to do everything. Small countries can provide useful niche capabilities, such as the Czechs' much-praised biological and chemical response unit. In the future NATO, as American defence officials envisage it, a British plane, say, using information supplied by an American satellite, might back up Norwegian troops on the ground.

Can those same officials imagine NATO itself running another military operation, as it did in Kosovo? “I wouldn't rule it out,” is the diplomatic reply. In other cases it might just do the force planning, as it may have to when Turkey assumes command of the security force in Afghanistan from Britain; in still others America might take over the leadership and planning, as it did in the Gulf war and in Afghanistan. The point to remember, say Pentagon officials, is that NATO's years of working together are the reason why America can call on pretty well all its various allies today for help in Afghanistan.

Preserving the ability to operate together is in everyone's interests. But that is something only NATO can do, using its own mechanisms and standards to preserve an “escalation continuum”, as Julian Lindley-French argues in a forthcoming report for the EU's Institute for Security Studies. Doing that would require at least the bigger Europeans, the British, the French and the Germans, to share more of the risks by maintaining the ability to operate alongside the Americans in many different circumstances, even if the rest provide only specialist help or foot-soldiers.

Preserving the ability to operate together—as only NATO can do—is in everyone's interests

NATO's command structure and planning mechanisms would also need reform. America will be pressing at the Prague summit for more high-readiness commands and mobile joint headquarters. One idea being floated inside and outside the administration is for the immediate establishment of a special-forces command to bring together the military skills America, Britain and others deployed in Afghanistan.

Some Europeans remain sceptical of this more militarised future. They argue, rightly, that the world needs "smart" development aid, not just smart bombs. But an alliance limited merely to that sort of burden-sharing, based on America's hard power and Europe's soft power, would give Europeans little real say over the strategic agenda. As Mr Lindley-French puts it, they would just be America's "garbage collectors". To avoid that fate, the European members of NATO will have to contribute more and better military capabilities too.

To avoid becoming America's "garbage collectors", European NATO must contribute more and better military capabilities

America's patience, meanwhile, is wearing thin. Marc Grossman, the under-secretary of state for political affairs, recently told the Senate Armed Services Committee that, in the end, it comes down to cash and hard choices for Europe. Pleading poverty, or pointing to the money Europeans are spending on reconstruction in the Balkans or elsewhere, only exasperates America's NATO-backers. "If they won't spend the money [on defence], it's not our fault," shoots back one frustrated senior official. After all, points out another, the EU has dollops of money to spend when it wants to: witness its recent decision to invest some *euro*3.3 billion ($3 billion) in Galileo, a satellite system that deliberately and needlessly duplicates America's Global Positioning System. American reaction to the European defence project is the same: it will be welcome if it comes off and can contribute to the common effort, but the Europeans must come up with the goods.

Into the unknown

If new capabilities are the test of Europe's commitment to NATO, the handling of enlargement will be a test of America's. The administration refuses to name names, insisting that any decision on new members will not be taken until nearer the summit. Meanwhile Richard Lugar, in the past one of the Senate's strongest supporters of a bigger NATO, now argues that, in the wake of September 11th, enlargement should be pursued only in a way that "strengthens not weakens" the alliance in its new military mission, and that new members must meet new NATO requirements.

Squaring the need for military efficiency with the president's wish for inclusiveness weighs most heavily at the Pentagon. All the would-be new members have drawbacks. The three Baltic states have tiny armies, but have been working hard together to develop useful niche capabilities. One official compares them to Norway, which has few forces but sent most of them to Afghanistan. Although the alliance should not take in basket cases, he argues, membership can help pull countries in the right direction. Bulgaria and Romania are keen and well-placed strategically, yet their military reforms still have a long way to go, with Romania looking less stable than it did before the last round in 1997 and Bulgaria described by one NATO official as "bottom of the heap".

Squaring the need for military efficiency with the president's wish for inclusiveness weighs heavily at the Pentagon

Elsewhere in the administration, the political advantages of enlargement seem to outweigh the operational disadvantages. "NATO decides to act at 19, but 19 don't have to act," argues one senior State Department official. Yet when it comes to intelligence-sharing, crucial to the fight against terrorism and weapons of mass destruction, NATO is already a two-tier, if not a three-tier, alliance. Does it make sense to dilute things further?

Knowing how much might hang on it, since September 11th all aspirants have been careful to act as if they were already NATO allies. That has been noticed. "I can handle an ally that says 'This is our fight'," notes a senior White House official approvingly. The alliance could anyway use new blood, he argues, "especially countries who take security seriously because they had to do without it" in the past.

NATO did not start with the 16 members it had at the end of the cold war, and it would be wrong to pull up the ladder now, says the Bush team. But does it make sense, asks one former insider, to bring into NATO so many of Europe's weaker democracies? If the Democrats had tried it, the Republicans would have loudly complained. Officials in charge of the American end of enlargement discussions insist they will be "unsentimental" in assessing progress. Slovakia is on notice that if its election in September

returns the distrusted Vladimir Meciar to power, no invitation will be forthcoming. Yet neither Bulgaria nor Romania looks any more stable.

And what of Russia? Vladimir Putin says he wants his country to play a more constructive role in Europe, politically, economically and in security too. Since September 11th he has aligned Russia more closely with America in the war on terrorism. The British proposal for NATO and Russia to meet “at 20” to discuss such issues at first caused apoplexy at the Pentagon, which was opposed to giving Russia even a hint of a veto over aspects of NATO policy. Some smaller members, and newer ones for which NATO membership was a means to escape Russia's shadow, were also hostile.

The proposals for a new NATO-Russia Council, soon to be put to NATO's foreign ministers and then aired at a NATO-Russia summit, fall far short of giving Russia that veto. If agreement eludes them, everyone retains the right to go his own way. But the idea is to work together at problems of common concern, such as terrorism, weapons proliferation, regional peacekeeping, missile defences, search and rescue and airspace management, reaching joint decisions where possible.

No one knows how this will work. Russia has to decide whether it will send a proper working delegation to NATO headquarters, like any other co-operating non-member. As trust builds, say NATO officials, the agenda can expand. Russian officials say they are ready to go as far as NATO is. But Mr Putin's wish to co-operate may not be fully shared by the foreign and defence officials he will have to rely on to make the whole thing work.

So what sort of NATO will emerge after Prague? A somewhat bigger, more political NATO, inevitably. A more militarily capable one, too? That depends on the resources everyone, especially the Europeans, puts into it. Whatever future awaits NATO, the past will be no guide.

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America and the Arab world

A delicate balance

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From The Economist print edition

EPA

George Bush's summit meeting with the leader of Saudi Arabia is raising expectations that are likely to be dashed

AFTER a nail-biting run of zig-zags, short-cuts and back-seat squabbling, George Bush has finally had the sense to stop and ask directions in his policy towards the Middle East. It is true that the man he asked, Crown Prince Abdullah of Saudi Arabia, upbraided him for dangerous driving and gave Mr Bush a map that he may not want to follow. But at least the occupants of the vehicle have a chance to think about where they are going.

The main achievement of last week's Crawford summit with Prince Abdullah was to involve Mr Bush himself more directly in Middle Eastern policy. In the past, he has intervened largely to support (or sometimes undermine) his emissaries. This time, he was the principal in the talks and in the diplomacy that followed.

Abandoning recent megaphone tactics, he twisted Ariel Sharon's arm privately to accept a compromise ending Israel's armed siege of Yasser Arafat's compound in Ramallah (see article). Some remembered that his father and Bill Clinton had both been reluctant at first to step into the Middle Eastern snake-pit, and wondered if he was about to get more involved.

Not necessarily; but this week's performance did suggest that something had changed. First, it showed an unmistakable, perhaps reluctant, recognition by the White House that the “Arab street” cannot be ignored, at least in the Middle East. Mr Powell's earlier visit had been deemed a failure throughout the region. Mr Bush's assertion that Mr Sharon was “a man of peace” had been met with incredulity and uproar. The Saudis, who were bearing the burden of Arab opinion with them to the summit, argued that indifference to the Middle East had wider consequences.

Mr Bush also seemed to show concern for deteriorating American-Saudi relations. American public opinion has turned sharply against the Saudi alliance since September 11th, an atrocity organised and largely perpetrated by Saudis. The Defence Department has been said to be moving troops and equipment out of the Prince Sultan air base in Saudi Arabia to Qatar, though Donald Rumsfeld has denied it. For his part, Prince Abdullah warned Mr Bush privately last year that the two countries' interests would diverge sharply unless America took more notice of Arab opinion about Palestine.

In a remarkable article in the *New York Times* on the day of the summit, unnamed Saudi sources (presumably approved by the crown prince) threatened to use oil as a weapon against America and

forcefully declared that “it is a mistake to think that our people will not do what is necessary to survive. And if that means we move to the right of bin Laden, so be it; to the left of Qaddafi, so be it; or fly to Baghdad and embrace Saddam like a brother, so be it.” And if this means America abandons the House of Saud to the wolves, so be it, too, presumably. The Valium pill of Mr Arafat's release was also designed to soothe this dangerously overheated talk.

Diplomatic activity in Israel has been accompanied by subtle shifts in the rhetoric about the war on terror. Officials at the Pentagon, who are the main critics of negotiating with Mr Arafat, have mostly turned their attention back to the unfinished business in Afghanistan. This is largely because all factions in the administration agree that an upsurge in al-Qaeda or Taliban activity is against American interests, whether you are worried about the Middle East or Iraq. But the effect is to focus the war on terror back on a country that does not raise hackles among Arab regimes.

At the same time, the Pentagon has taken the opportunity to remind everyone that it has not forgotten about Saddam Hussein. In another intriguing *New York Times* leak, Pentagon officials revealed that they had given up the idea of overthrowing the butcher of Baghdad by a coup, or an Afghan-style air campaign, and were developing plans for invading Iraq with up to 250,000 American troops.

Paradoxically, however, this may take some immediate pressure off Arab allies who oppose—at least in public—an attack on Mr Hussein. For no credible timetable was attached to this contingency plan, which could not begin until next spring at the earliest. And there is little sign yet of the sort of real preparation that would be required for such an attack, though a large ramp is under construction at the base in Qatar. In short, over the past week, America seems to have deferred an attack on Iraq (while implying it will one day take place) and stepped up its efforts in the Middle East—presumably in the hope that by the time it is ready to invade Iraq, it will no longer be distracted by Israel.

That, of course, is the delicate balance it must strike if it is to overthrow Mr Hussein without provoking a confrontation with the whole Arab world. There is just one tiny problem, or three. The summit with Prince Abdullah on which so much seems to depend is regarded in Saudi Arabia itself as a failure. It is not clear that Mr Bush is really committed to the sort of consistent Middle East policy that could dampen down the conflict and, that being so, Mr Sharon or Mr Arafat could wreck his careful balancing-act at any time.

The crown prince himself was a reluctant summiteer. Before the visit, many Saudis expected it to be cancelled. Prince Abdullah's vaunted “peace plan” for Israel—adopted by all members of the Arab League—seemed to have been swept away by Mr Sharon's incursion into Ramallah the very next day. Against that background, the real issue for Prince Abdullah was not Mr Arafat's freedom of movement, but Mr Bush's ability to bring the Israelis to the negotiating table, as the crown prince had done with the Arab regimes.

It is far from clear that Mr Bush is even trying to do that. The Saudis presented him with an eight-point plan leading to a comprehensive peace settlement. So far, he has adopted only point one, ending the siege of Mr Arafat. That suggests that even if the president has decided to get more deeply involved in the Middle East, he is still hankering after the sort of incremental approach that has failed repeatedly in the past year or so.

That in turn suggests that Mr Bush has not yet resolved the basic ambiguity in his policy. He is simultaneously supporting Israel in its war against terror and trying to find a “strategic balance” in the region as a whole. Indeed, in yet another leaked story last week (this time in the *Washington Post*), State Department officials complained bitterly that the White House was continuously undermining their attempts to find a “strategic balance” by increasing pressure on Mr Sharon. In the absence of a consistent American policy, the risk is that Mr Sharon or Mr Arafat will wreck whatever balance Mr Bush, or the State Department, imagine they are on the brink of achieving.

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Los Angeles

Ten years on

May 2nd 2002 | LOS ANGELES
From The Economist print edition

The city survived the riots and is thriving. But it may yet break apart

Get article background

AP

A smile for the LAPD

CAN coffee and doughnuts revive a neighbourhood? The people of South Central Los Angeles, where the worst American riots of the 20th century erupted ten years ago, certainly hope so. In South Central the opening of a branch of Starbucks, or of a Krispy Kreme doughnut shop, is still rare and cause for celebration.

The riots were triggered by the acquittal of four white police officers who had been recorded on videotape beating Rodney King, a black man caught after a high-speed car chase. The four days of arson, looting and violence that followed left 54 people dead, sent 2,400 to hospital, and destroyed $1 billion-worth of property. Fury at the brutality and impunity of the Los Angeles Police Department (LAPD) had simmered a long time, but poverty had stoked the fire. The immediate need was therefore not only to revive trust in the police, but also to tackle the lack of resources and opportunity in the neighbourhoods where the rioting had broken out.

The LAPD still has many troubles: a shortage of officers, low morale and scandalous evidence of corruption among its anti-gang officers. But black anger at the police has diminished, not least because both commissioners since the riots have been black. Bernard Parks, who will resign as commissioner on May 5th, has insisted on attending to small complaints. This made him unpopular among the officers, but it has meant more courteous day-to-day encounters with blacks, and they rallied to him when James Hahn, the mayor, announced in February that he did not want Mr Parks to serve a second term.

The financial revival started with more fanfare but has been much less dramatic. Peter Ueberroth, who had made the Olympic Games a huge, profitable success for Los Angeles in 1984, led Rebuild LA, which raised $400m to invest in areas damaged by the riots. But big corporations showed little interest in building new manufacturing plants in neighbourhoods with high crime and low education, and large investors stayed away. Big schemes have given way to more modest projects.

Hence the cheers for coffee shops. Today's investors move one small business at a time. Magic Johnson, a retired basketball star, has set up a string of cinemas, restaurants and shops in inner cities across the country, starting in Los Angeles. Operation Hope runs seminars in South and East Los Angeles to teach entrepreneurs how to apply for small loans, and at the same time has worked with banks to secure commitments for mortgages and business loans. The large funds, such as the California pension scheme, or an inner-city fund started by Merrill Lynch, an investment bank, are learning to channel their money through smaller operators.

By now, the grassroots efforts have won wider attention. On April 29th, the anniversary of the beating verdict, George Bush visited the First African Methodist Episcopal Church, which survived the flames at the heart of the riot zone. He admired the work of FAME Renaissance, the church's investment arm, which has a $2m venture-capital fund and $6m to provide grants to minority small businesses. It exemplified, he said, the power of “faith-based” groups to deliver social and economic aid to their communities, the kind of thing he would like to see more of.

The retreat of big business and the rise of smaller firms mirrors a larger pattern in Los Angeles. The riots

caught the city early in a period of structural change triggered by the end of the cold war. The large aerospace firms that had underpinned the southern Californian economy for decades shut up shop, and in their place has come an economy based on small businesses. Light manufacturing—of clothing, jewellery and toys—import and distribution, entertainment with its myriad supporting trades, and electronic technology have all contributed to a revival in the fortune of Los Angeles that belies the gloom of the early 1990s. This diversity has helped southern California withstand the recession more successfully than San Francisco, which bet so heavily on the Internet.

But Los Angeles is still unstable. The threat this time is not conflagration, but fission. The San Fernando Valley, which makes up the northern third of the city and is separated from most of it by the Santa Monica mountains, feels poorly served by its parent. Though Valley people pay high city taxes, the costly subway system barely reaches them, and most money for the schools, they feel, is sucked up before they see it. A long-festering proposal to split off as a separate city, with a population of 1.4m and a diverse economy, may be brought to a vote in November.

The secession movement, which has also taken root in Hollywood and around the port, is another expression of the feeling that the city does not care much for the welfare of its citizens. South Central Los Angeles was right that it was poorly served, though its violent protests were mostly self-destructive. The Valley too has valid complaints, and its proposed solution may herald the break-up of the city. Los Angeles, with its vibrant mix of races, has often seemed to show America its own future. But on this question, the city may find that the nation—which from the start chose to devolve power to states and cities, rather than manage everything from the centre—had the right idea all along.

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Virginia's Republicans

Severely bugged

May 2nd 2002 | RICHMOND, VIRGINIA
From The Economist print edition

Tapping people's telephones is a foolish thing to do

DESPITE their recent ascendancy, Virginia Republicans seem adept at sabotaging themselves. The latest embarrassment has been the indictment of Edmund Matricardi, formerly executive director of the state party, for eavesdropping on two telephone conferences in March between leading Democrats, one of them involving Mark Warner, the state's new governor. Mr Matricardi is said to have recorded and transcribed the calls and then passed the information on, though prosecutors will not say to whom. If convicted, he could go to prison for 20 years.

As political controversies go, this is small beer, but it fits a self-destructive pattern for the Virginia Republicans. Majorities in the House and Senate have allowed divisions to open up within the Republican Party. In the 2002 General Assembly session, centrists fretted over fiscal policy while the right wing argued for more restrictions on abortion and for symbolic social legislation, including one bill—eventually withdrawn—requiring public display of the Ten Commandments.

The tension clearly weakened the Republican candidate for governor last year and helped Mr Warner. His victory led in turn to national humiliation for Virginia's Republicans when James Gilmore, the previous governor, was replaced as chairman of the Republican National Committee.

Virginia's Democrats had their own scandal over electronic eavesdropping a decade ago. A federal investigation nearly led to the indictment of Charles Robb, the last Democratic senator from Virginia before Mr Warner. The scandal intensified bickering within the Democratic Party and hastened its decline, as jittery Republicans remember only too well.

The bickering is not confined to one party now. Last year Mr Warner campaigned against Mr Gilmore's high-handedness with the legislature and promised to ensure co-operation between the parties. The Matricardi affair has put an end to that plan.

The eavesdropping case has also complicated the already knotty matter of redistricting. After breaking a century of Democratic legislative hegemony in November 1999, Republicans in the House of Delegates artfully went about drawing many remaining Democratic antagonists out of their districts. But a judge ruled that they had gone too far, boosting their numbers in heavily white regions by racial gerrymandering elsewhere. The judge also ordered special elections this autumn. That enraged Republicans, but it also raised fears that the party could lose seats.

Legal manoeuvering by Republicans is now largely directed at averting fresh elections. That was where Mr Matricardi came in. The calls he listened in on were debates about the Democrats' next move in the redistricting dispute, which is now on its way to Virginia's Supreme Court and may go all the way to the federal one.

The investigation and indictment of Mr Matricardi may have made it difficult, if not impossible, for the Republicans to challenge the trial judge's objectivity by spotlighting his Democratic pedigree. They now have plenty of questions about their own partisanship to answer.

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Rhode Island

A surfeit of sauce

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From The Economist print edition

Has the mayor of Providence finally gone too far?

AP

Bad days for Buddy

THE citizens of Providence, Rhode Island never thought their mayor was a choirboy. After all, Vincent Cianci—"Buddy" to all the world—was convicted in 1984 of kidnapping his then wife's alleged lover and torturing him with lit cigarettes. But he was re-elected anyway, and is now the longest-serving big-city mayor in America.

He owes his success to his considerable charm and enough old-time political razzle-dazzle to make Bill Clinton look shy. On his permanent campaign, Mr Cianci kisses anything that moves: not just babies, but baby pigs. He even sells a spaghetti sauce ("Mayor's Own") to raise money for charity and to put his face in supermarkets all over town.

That charm is now being tested once again. On April 23rd Mr Cianci and several of his aides went on trial in federal court on charges of graft, extortion and racketeering. The FBI's investigation turned up over $1.5m in bribes for city contracts and favours. The mayor's take allegedly included $250,000 in illegal campaign contributions from tow-away companies, and free lifetime honorary membership of the exclusive University Club (which had once rejected his application) in exchange for permission to build new squash courts.

It is hard for locals to turn their backs on Mr Cianci. He had helped turn Providence from a rusting textile town into one of the most pleasant cities in the north-east. It may not be "the San Francisco of New England", as its boosters claim, but Mr Cianci has cut crime and brought back both businesses and culture into the redeveloped centre of town.

Besides, this state, once nicknamed "Rogues' Island", has a long history of tolerance towards nonconformists and troublemakers. Its founder, Roger Williams, was hounded out of Puritan Massachusetts for his radical religious beliefs. But some bad behaviour is harder to take. In the 1970s and early 1980s, the city became a centre of Mafia activity and corruption reached as high as the state Supreme Court. Many had hoped, or pretended, that the bad old days were past. Now a jury may force the city to face facts.

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Children's rights

Oh, and Somalia too

May 2nd 2002
From The Economist print edition

America's almost solitary refusal to do the decent thing

BEING a child can be no fun these days. According to UNICEF, 1.4m children under 15 are living with HIV, and 13m have been orphaned by AIDS. Between 1990 and 2000, conflict killed 2m children. Over 100m of primary age do not attend school, while 149m are malnourished. At the 1990 world summit for children, national leaders pledged to improve matters. On May 8th-10th, the UN general assembly will hold a special session on children to discuss what still needs to be done. The United States, as ever, is not in the mood to give the UN an easy ride.

Besides the now familiar bickering over family planning and abortion, discussions ahead of the session are snagging on the 1989 UN convention for the rights of the child. The convention—which sets standards for health care, education, social services and so on—is supported by all but two countries, the United States and Somalia. The Clinton administration signed the document in 1995, but it was never sent to Congress for ratification. And American negotiators have no intention of letting the rest of the world use the convention as a centrepiece for the special session.

Why the fuss? To begin with, convention members are not supposed to execute children. In America, however, 23 states allow the death penalty for people who were under 18 at the time of their crimes. Since 1985, 18 child offenders have been executed—half of them in Texas—and another 84 were on death row in November 2001. If it ratified the convention, America would be under pressure to give up this practice.

Another issue is whether children should be listened to. The treaty's opponents—who found a vocal advocate in Jesse Helms, the senior senator from North Carolina—maintain that the convention, which argues that children's views should be taken into account, undermines parental authority. Some have nightmarish visions of ungrateful brats suing their parents and of UN bureaucrats, in effect, taking over family life.

According to Howard Davidson of the American Bar Association, this is nonsense. The convention, he says, offers no basis for legal action, and children from the 191 countries that are part of the convention are not dragging their parents to court. In any case, adds Jo Becker of Human Rights Watch, the treaty, while outlining children's rights, clearly promotes the central role of parents and families.

Deep hostility to the UN in general also shapes America's attitude. According to Janice Crouse from Concerned Women for America, a conservative women's group, the international body is meddling far too much. Ms Crouse points out that American children are already protected by American laws, which are fine, and that the convention would only undercut national sovereignty.

Lawmakers, however, may feel differently. The convention's associated protocols—which condemn the use of child soldiers as well as child prostitution and pornography—are likely to be ratified by the Senate in the next few weeks. In the meantime, however, the convention itself is still sitting in the White House. It took over 30 years for the United States to ratify the genocide convention. Will children have to wait that long?

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American Jews in Israel

Why they go

May 2nd 2002 | JERUSALEM AND NEW YORK
From The Economist print edition

Present events in Israel are reviving a passionate bond

Reuters

The voice of solidarity

WHEN Larry Zicklin, the president of the UJA-Federation of New York, a Jewish charity, thought in early March that he might organise a package tour to Israel, few people seemed interested. But after the Passover killings on March 27th, and with reports of a rising wave of anti-Semitism in Europe, all that changed. By last Sunday, 164 people had signed up.

One was Joe Cooper, an elderly stockbroker, returning to Israel as he had at the time of previous wars in 1967, 1973 and 1991. “The world has taught us that if we do not support ourselves we will lose the right to exist, and that has never been more important than now,” he says. His sentiments are echoed by a frail elderly woman, Leah Tolpin. “We always go,” she says, “when there's trouble.” Howard Waxman, who is in New York real estate, intended to spend his holidays cycling in France. Instead, because France no longer seemed to deserve visitors but Israel did, he found himself on Monday sipping a soft drink in a Sparro's Restaurant in downtown Jerusalem that was bombed several months ago. “There should be at least one person coming here,” he says.

The American visitors speak of the shared legacy of facing anti-Semitism, of losing relatives in the Holocaust, and of awe for Israel's progress over the years. They fear that tolerance for the repressive regimes on Israel's borders could mean that all this is lost. If more noise about this is made in America than elsewhere, says Lee Podair, a lawyer who grew up in the Bronx, it is because in America there is enough freedom to do so.

Their visit starts with a lecture. Detailed maps of Jerusalem give each Arab and Israeli residential area in minute detail, showing how hard it will be to draw the borders of a new Palestinian state. Then there is a trip to the Gilo housing development on Jerusalem's rim, which has been the target of snipers. At a hospital, a 14-year-old girl tells how she was hit by more than 100 pieces of shrapnel while standing outside a coffee house, and two Israeli border guards recount how they were shot while protecting children in a park from a terrorist. Other soldiers describe, from their point of view, the fighting in Jenin.

Across the broad spectrum of Jews in America there are varied opinions about Israel, as there are about Judaism itself. Many American Jews are appalled by the recent military actions, and some even believe that, given the intractabilities of the Middle East, Israel really should cease to exist. In the mid-1990s, when the outlook for peace in the Middle East seemed bright and Israel's economy was prospering, Mr Zicklin's organisation was on the point of shifting some of its efforts in Israel to projects in Russia and Argentina.

Yet since the attacks began again two years ago, support for Israel among American Jews has grown dramatically, says Mr Zicklin. Contributions to his charity are rising fast, and are now being used to provide emergency help such as shelters. Another traveller on the package tour, Bernard Nussbaum, a New York lawyer and former counsel to President Bill Clinton, says Mr Arafat's efforts have produced a result few thought possible: a growing sense of unity among America's Jews.

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Lexington

Sulks by the dance-floor

May 2nd 2002
From The Economist print edition

The Bush administration is experiencing something unfamiliar: discontent on the right

ONE of the cardinal rules of politics is that “you dance with the one that brung you”. When George Bush senior broke this rule by raising taxes, signing the 1991 Civil Rights Act and generally going wobbly, his presidency imploded. Is the son repeating the sins of the father?

In the past few months George Bush has done almost nothing but spurn the ones that brung him. He ditched free trade by embracing steel tariffs. He signed a campaign-finance reform bill which he once described as an affront to the constitution. He stepped in too late to save a conservative judicial nominee, Charles Pickering. And—his biggest sin by far in the eyes of conservatives—he compromised the purity of the Bush doctrine on terrorism by trying to rein in Israel's incursion into the West Bank and sending Colin Powell to negotiate with Yasser Arafat.

Social conservatives complain that they are “getting very uneasy about this presidency” (Paul Weyrich) and that “a sense of disappointment is spreading” (Gary Bauer). The neoconservative *Weekly Standard* fumes that Mr Bush's flim-flamming on Israel has left him “lost in the wilderness without a moral or strategic compass”. The *Wall Street Journal* editorial page, the bible of the right, implores the White House to “let Bush be Bush”.

Activists also complain that the White House is failing them on bread-and-butter issues. Congressional Republicans fret in private that Mr Bush has failed to use his wartime popularity to push through their legislative agenda. Grass-roots activists complain that the White House has persistently supported moderates against conservatives in Republican primaries: witness its backing for Elizabeth Dole in South Carolina, Lamar Alexander in Tennessee and, disastrously, Richard Riordan in California.

Is there any chance that this revolt will grow? Marshall Wittmann, of the Hudson Institute, probably speaks for most political analysts when he says he doubts it. He likens the current spat between Mr Bush and the conservatives to a lovers' quarrel, rather than the beginning of divorce proceedings.

George Bush is shielded from right-wing anger by the fact that he is far more conservative than his father. His first move on becoming president was to pass a gigantic tax cut, cementing his conservative base. He delighted social conservatives by making John Ashcroft his attorney-general, and thrilled neoconservatives by withdrawing from the ABM treaty. Mr Wittmann adds a nice point: the current inhabitant of the White House has not been in politics long enough to acquire a record of betrayals.

Having cut his teeth in politics as his father's ambassador to the conservative movement, Mr Bush is also assiduous about shoring up his base. At the moment he devotes more time to cloning, an obsession with the right, than almost any other domestic issue. Karl Rove, his political guru, is a fixture at conservative

confabulations across the country. One reason for the apparent confusion of Mr Bush's Middle Eastern policy is his determination to appease the right. Would any other American president allow Israel to take so long to withdraw from the West Bank?

George Bush's other big advantage is the growing maturity of the conservative movement. The infantile tantrums conservatives threw during the first Bush administration are no longer fashionable. They have been forced to grow up by two traumatic events: the sight of Bill Clinton, a man who embodies everything they most loathe about the baby-boom generation, lording it in the White House, and the Florida recount.

Conservatives realise that they cannot take their control of the White House for granted. George Bush lost the popular vote. Vital states like Florida are trending Democratic. Congress is almost equally divided between the two parties. The last three presidential elections have produced presidents who won with less than 50% of the vote (something that happened four times in a row in the late 19th century). A collapse of party discipline could easily hand the White House to one of Slick Willy's heirs.

Wanted: proofs of love

But the fact that Bush the younger is in a much stronger position than his hapless father does not mean that he can ignore the sulking on the right. Sulking there is encouraging sniping on the left. Since September 11th, mainstream Democrats have been hesitant about criticising Mr Bush on anything to do with terrorism. But the more leading Republicans accuse Mr Bush of running a morally bankrupt foreign policy, the more leading Democrats like Joe Lieberman feel free to do likewise.

Right-wing sulks may also signal something as harmful to Mr Bush as open revolt: electoral apathy. The last presidential election saw about 4m evangelical conservatives, once reliable Republican voters, staying at home. Mr Bush may be able to re-engage evangelicals by getting cloning banned. But this will count for nothing if they conclude that he is putting pragmatism above principle on Israel, a country evangelicals revere both as a home for God's chosen people and as the scene of the “end of days”. The stakes are particularly high because the impending ban on soft money, which will kick in after the November elections unless it is ruled unconstitutional, will make the Republican Party far more dependent on the sort of small donations that come from grass-roots activists.

The make-or-break issue for Mr Bush, however, will be Iraq. Mr Bush aroused huge expectations on the right when he promised to confront the “axis of evil” and extend the war against terrorism into a war against heavily armed toxic states. He has repeatedly stated his determination to mount a war against Saddam Hussein to damp down criticisms of his Middle East policy. If Mr Bush fulfils his promise to liberate Iraq, he will be guaranteed a place in the conservative pantheon alongside Ronald Reagan. If he breaks his promise, and leaves Saddam in place, this may spell the end of a beautiful relationship.

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Post-coup Venezuela

Chavez at bay

May 2nd 2002 | CARACAS
From The Economist print edition

AP

A man with many troubles, Venezuela's president is being conciliatory. That is out of character and may not last

Get article background

HE CAN stay in power. Or he can seek to further his revolutionary aims. Hugo Chavez, Venezuela's populist president, cannot have it both ways—at least, that is how most of his critics see things after the bungled coup attempt of April 11th-13th, which came close to destroying his three-year-old “Bolivarian revolution”.

As he licks his wounds and seeks to regroup his shell-shocked supporters, Mr Chavez faces a gloomy outlook on the political, military and economic fronts. Then there are relations with the United States, Venezuela's main trading partner, which may or may not have been involved in the coup, but either way would dearly love to see the back of him. Perhaps the only bright spot for Mr Chavez is the backing he received from elsewhere in Latin America, though that could soon shrivel if he fails to restore calm at home.

In politics, the president has been reaching out to his opponents. For example, he has met opposition media and church figures, who had not darkened the door of the official residence since the early days of his government. A presidential “dialogue commission” has been sworn in. Moves are afoot to amend 17 of his most unpopular decree laws.

Mr Chavez has also promised a cabinet shake-up. He has started by replacing Diosdado Cabello, the controversial vice-president, with Jose Vicente Rangel, previously the defence (and earlier foreign) minister. Mr Cabello organised the “Bolivarian circles”. Opponents see these pro-Chavez groups as an embryonic militia, and accuse them of firing on unarmed demonstrators on the day of the coup.

Mr Rangel, a master of realpolitik, is the government's main link with opposition politicians and business leaders. The coup has strengthened his position against the *talibanes*, as the unquestioning, pro-Chavez radicals like Mr Cabello are dubbed. But ultra-radicals, some in the army, who regard Mr Chavez as a pseudo-revolutionary, but who helped to restore him to power, also feel invigorated. The fact that Mr Chavez at first went quietly, despite his pledge to defend the “revolution” with his life, and reports of the tears he shed after surrendering to the army in the early hours of April 12th, have cost him points in a macho culture.

Though Mr Chavez's “revolution” has often verged on farce, and is dogged by incompetence and corruption, it has radical pretensions. These are not confined to Venezuela, but are regional in scope. That is a cause of friction with the United States, which looks askance at Mr Chavez's coolness towards the proposed Free-Trade Area of the Americas and American military aid to Colombia.

But if it fails to improve the lives of the poor, the “revolution” is doomed. And Mr Chavez is running out of cash. His revolutionary rhetoric and high-handedness have scared away investment. “The country's industrial zones are cemeteries,” says Manuel Felipe Sierra, a political commentator. The economy is set to contract by 2% or so this year.

The government itself is close to bankruptcy. The coup attempt has stalled Mr Chavez's bid to take direct control of the management of the state oil company, the main source of government revenue. Austerity measures announced in February have not been implemented in full, according to Francisco Rodriguez, the economic adviser to the National Assembly and a former ally of the president. Opposition economists forecast a fiscal deficit of up to 9% of GDP this year, and say the government will not be able to finance more than five points of that. Mr Rodriguez suggested that the government enter into an agreement with that bogeyman of revolutionaries, the IMF. Any big change in economic policy would start with the sacking of Jorge Giordani, the planning minister. Despite being a favourite of Mr Chavez, he seems set to go.

Then there are the armed forces. About 100 of the top brass came out against Mr Chavez during the two days he was held prisoner. They have been embarrassed by the failure of the coup. But the president's claims that the army was a pillar of the “revolution” were exposed as hollow.

For all that, Mr Chavez remains the democratically elected president of Venezuela. The constitution contemplates a referendum on replacing the president, but only when he is half-way through his term, in January 2004. That looks a long way off. Mr Chavez's room for manouevre has narrowed. But barring his unlikely conversion to consensus politics, he is likely to remain an unpredictable irritant to Venezuela's opposition and to the United States alike.

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Politics in Mexico

The frustrating of Fox

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From The Economist print edition

The presidency is no longer all-powerful. That is bad for the government's reforms, but good for the country

EPA

Our lazo is bigger than yours, Señor Presidente

“I NEVER get frustrated with anything”, President Vicente Fox declared last week. Just as well: the inability of his 17-month old government to make any headway with its ambitious agenda of reform would have driven a sane man to a nervous breakdown by now. It may be fortunate for Mr Fox that he is so laid-back, but that is also emerging as one of the government's biggest problems.

The headaches start with Congress. On April 30th it wound up a session which had begun last September and yielded almost no legislative gains for the presidency. The only bit of good news came right at the end. This week, the Senate followed the lower house in passing unanimously a freedom of information bill, which could have a big impact on making government more open. But its passage was a shining exception to the rule: every other government bill of any substance has become mere canon-fodder in a war of attrition between Congress and the presidency. For example, Mr Fox's tax reform was mangled out of recognition late last year. And Congress has sat on reforms of the constitution, the electoral system, the labour market, education and energy.

Now the Supreme Court, too, is holding the president back. On April 25th, the court ruled unconstitutional a decree that had allowed some private investment in the state-run energy sector. This is essential to meet increased demand for electricity. But the court said that Congress alone has the power to alter energy regulations.

So the transformation of Mexico, seemingly promised by Mr Fox's election after seven decades of rule by the Institutional Revolutionary Party (PRI), has not yet started. Or has it? Many, especially in Congress, argue that the obstruction of the president is just a healthy sign of Mexico's new, flourishing, democracy. After a century or so with an all-powerful presidency, for the first time the constitutional “separation of powers” means just that.

That is partly because the PRI has a majority in both houses of Congress. It wants revenge for its defeat by Mr Fox in 2000. It has an interest in ensuring that his conservative National Action Party has little to show the voters in a congressional election next year. But much of the confrontational spirit stems from a desire to assert the rights of the legislature, treated for so long like a rubber-stamp. A favourite word of congressmen is “dignity”. This trend started in the mid-1990s, when the PRI temporarily lost its majority in the lower house. And it is a trend that makes even Mr Fox's own party difficult to control.

Healthy though it may be, this leaves Mexico at an impasse. Strip away the informal powers of patronage, money and party control that buttressed the PRI's rulers, and the formal constitutional powers of a Mexican president are weak, points out Luis Rubio, a political analyst.

So what can Mr Fox do to rescue his reforms? This week he tried a charm offensive. He met the leaders of the four main parties in the Senate, which last month, in an unprecedented vote, forced him to cancel a trip to the United States because it disagreed with his preference for George Bush over Cuba's Fidel Castro. Polls show that in this, as in many other matters, Mr Fox has public support.

The challenge is to use that support to seize the initiative from Congress by arguing more forcefully for change. Rodolfo Elizondo, Mr Fox's press secretary, said this week that the “people around him would like to see him be more aggressive, more on the offensive”. In other words, if Mexico's presidency is to start clawing back power, this time democratically, the incumbent needs to be less laid-back.

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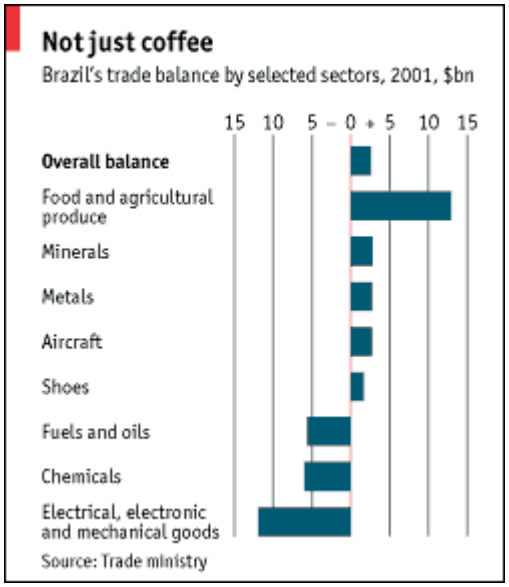
Brazil's economy

Chips on its shoulder

May 2nd 2002 | SAO PAULO
From The Economist print edition

Wanted: more high-tech factories



LOOKING enviously at Asian tigers such as Taiwan and South Korea, which have become big exporters of high-tech goods, Brazil dreams of becoming a Latin jaguar. Last year, after six years of external deficits and a big currency devaluation, it finally achieved a surplus in its trade in goods of $2.6 billion. But this was dwarfed by a $27 billion deficit in services, debt payments and other invisibles. The prices of the country's exports of food and raw materials remain weak. The answer, says the government, and its opponents agree, is to boost production and exports of more sophisticated goods, from electronics to petrochemicals.

Jose Serra, the presidential candidate of President Fernando Henrique Cardoso's Social Democrats, argues that Brazil must now take a “leap” into becoming a maker of microprocessors, just as previous government-backed plans turned it into a big producer of steel, and then cars. But like several of its neighbours, Brazil is still smarting from Intel's decision in 1996 to choose tiny Costa Rica for its first microchip plant in Latin America. The government hopes to persuade Intel's chief executive, who is due to visit Brazil next month, to build a similar plant there.

The timing is not propitious. Last month, Dell postponed a planned expansion of its computer assembly plant in southern Brazil because of the slump in the electronics industry, and weak economic growth. Even so, it is worth the government putting in a bigger effort than it did last time, when ministers reportedly were unwelcoming to Intel managers, fobbing them off with junior officials. But in the end, bagging a chip plant may depend on the government's willingness to give subsidies and tax breaks. State governments have long wooed car firms with such sweeteners—and been criticised for wasting taxpayers' money in doing so.

The trade minister, Sergio Amaral, says a new law offering tax breaks to information-technology firms is leading to higher investment. But a welter of taxes on business mean that, even with such incentives, the burden remains high. Reforms of the tax system, which perversely favours imported components over locally made ones, have been promised for years. But both the government and Congress have so far shrunk from the reform, which would create losers as well as winners. Neither is there any prospect of a constitutional change to end big incentives to put factories in Manaus, in the heart of the Amazon jungle, which means taxes on firms in more suitable industrial locations are higher than they would otherwise be.

All the candidates in this year's presidential election make vague promises of more active industrial policy to promote investment. But that could backfire. Talk of a return to price controls in oil and petrochemicals may discourage investment in those industries for example. The best way to make Brazil a more attractive place for manufacturing investment is to bring costs down. And that means fixing the tax system, liberalising labour markets and, above all, cutting public borrowing and so bringing interest rates down.

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Argentina's collapse

New man, old woes

May 2nd 2002 | BUENOS AIRES
From The Economist print edition

Roberto Lavagna's improbable mission

Get article background

EPA

In Latin America's toughest job

HIS appointment brought soothing words from the IMF and the United States' Treasury. But a better guide to the prospects of Roberto Lavagna, named on April 27th as Argentina's sixth economy minister in 14 months, may be the difficulty he has faced in finding economists willing to join his team. Then he must try to persuade reluctant politicians to take the measures required to reach a deal with a sceptical IMF.

Mr Lavagna, formerly Argentina's ambassador to the EU and the WTO, is a shade more heterodox than his predecessor, Jorge Remes Lenicov. But Mr Remes's resignation showed where power lies—or rather where it does not. When President Eduardo Duhalde showed signs of wanting to abandon the search for an IMF deal last week, the provincial governors from his own Peronist party stepped in and forced him to agree a 14-point plan. This includes all the measures demanded by the Fund—and sought fruitlessly by Mr Remes.

Will this be enough to clinch a deal? The Fund wants to see measures, rather than promises, such as one to present to Congress a reform of provincial finance within 90 days. Meanwhile, the government is failing to contain the fiscal crisis: in real terms, tax revenues in the three months to March were 29% lower than in the same period last year.

Then there are the banks. They opened again on April 29th, after being closed for a week. Mr Remes resigned after failing to persuade Congress to approve a plan to turn savings deposits, frozen since December 1st, into bonds. Mr Lavagna may now implement this plan by decree. Decreeing recovery will be a little harder.

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Crime in Bolivia

Policing the police

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Some of the criminals wear uniform

A GENERATION or so ago, coups and revolutions were rather more common than violent crime in Bolivia. No longer: a wave of armed robberies has alarmed businesses, while theft and muggings have led frustrated citizens to take the law into their own hands. Over the past two years, several suspected offenders have suffered public beatings, lynchings and even burnings at the hands of angry mobs. And the police? In the few areas where they are present, they are often part of the problem, say many Bolivians.

Since the present conservative government took office in 1997, four police commanders have come and gone, sacked over claims of corruption, abuse of power or links with organised crime. The media are full of revelations about police links to drug trafficking and stolen vehicles, nepotism in the force, and the charging of illegal fees for services. Officers on meagre salaries have been found to live in mansions.

Even more shocking is evidence that some police officers have themselves been actively engaged in violent crime. A criminal gang accused of a series of audacious armed robberies turned out to include a police colonel and a major in its ranks. A week after their arrest, a car bomb exploded outside police headquarters in Santa Cruz, Bolivia's second city.

The core of the problem is impunity. Complaints of police abuse rarely end in a trial, let alone a conviction. A recent study found that 25 out of the police's 77 senior commanders face investigations that have not been concluded. This is compounded by the police's meagre official budget, and habit of raising their own revenue, according to Ana Maria Campero, Bolivia's ombudsman. Annual salaries are low ($20,000 a year for the police chief; $3,200 for a typical detective), making officers susceptible to even petty corruption. At the same time, revenues raised from the issue of identity cards, vehicle certificates and driving licences are not properly accounted for.

There has been much talk of reform, but little action. Since 1997, four interior ministers have failed to crack the problem. Crime and policing have become an issue in next month's presidential election. Ronald MacLean, the candidate of the ruling party, has even suggested restoring the death penalty. But that looks like a confession of failure. And anyway, should it be applied against the police themselves?

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Pakistan

The general's empty victory

May 2nd 2002 | ISLAMABAD
From The Economist print edition

With his referendum Musharraf has made life harder, not easier, for himself

Get article background

Getty

IT PROBABLY seemed like a good plan at the time. Lauded in the West for backing America's war on terror, and admired at home for taking on both corrupt politicians and extremist mullahs while avoiding dictatorial excess, General Pervez Musharraf must have thought that he would sail through this week's referendum on his assumed presidency, and use it to cement himself into power. On April 30th the electorate duly granted the general a five-year presidential term. But his problems may only now be beginning.

As bogus political exercises go, this one was a corker. The poll was conducted without the benefit of an electoral register, identity cards were not obligatory and the usual polling stations were supplemented by tens of thousands of makeshift extra ones: in railway stations, offices, on street corners, in hotels. Businesses and government outfits were leant on heavily to ensure that all their employees voted. Oodles of government money was lavished on plastering the country with posters of the general in a startling variety of outfits and on festooning the main streets with banners bearing such sentiments as “We love Pakistan. We love Pervez Musharraf”.

As bogus political exercises go, this one was a corker

The referendum question itself was phrased so as to make a No seem unthinkable. It asked the voter to endorse a five-year term in order to permit economic recovery, the restoration of democracy, the ending of extremism and “the achievement of the vision” of Muhammad Ali Jinnah, Pakistan's founder. Just in case, the Yes box was coloured green, the colour of Islam and the Pakistani flag. This being so, the official figure of 97.5% in favour is probably reasonably accurate. With all but a couple of tame general-supporting parties urging a boycott of a referendum they have rightly condemned as unconstitutional, the real test of the president's popularity was the turnout.

Naturally, this is being fiercely contested. The opposition maintains that as few as 5% may have voted. The government was claiming a figure of more than 50%, which no one outside it finds remotely credible. Reporters found polling station after polling station all but deserted. At one, in a junior school in Lahore, only one woman and seven men had voted by late in the afternoon.

No one, however, seems particularly interested in trying to overturn the result, which was predictable and changes very little. Instead, attention is now focused on elections that must be held by October, according to the Supreme Court, which approved the general's seizure of power in 1999 but gave him just three years to clean up the country and restore the constitution he suspended. The general has always promised to respect that ruling. But over the past few months it has become clear that he has no intention of shuffling back to barracks. He wants to stay on as president, with enhanced powers to oversee the work of the elected prime minister, and to institutionalise the armed forces' role in public life by means of a powerful National Security Council which the men in khaki would dominate.

Referendum or no referendum, this will not be easy. The Supreme Court has now thrown a large spanner into the works. Though it did not, as opponents of the general had hoped, rule the referendum exercise unconstitutional, it did the next best thing. The referendum, the court said, in a judgment handed down on April 27th, was perfectly legal, but only under the emergency regulations promulgated by the general himself after he seized power in 1999. Any conflict between it and the constitution (which there evidently

is, since the constitution says the president must be elected by a college of Pakistan's national and local parliaments) will have to be sorted out later.

This puts the general in a quandary. He could rewrite the rules of the constitution, or simply refuse to restore it at all; but he has promised not to do this, and if he breaks that promise even the Americans may become hostile. The general's usefulness is already in some doubt, because of reports that many of the extremists he so obligingly jailed in January have subsequently been released. If, on the other hand, the general keeps his promise, and restores the democratic constitution, the Supreme Court decision means that his presidency risks becoming legally invalid, despite the referendum.

To keep his job, he would need either to persuade parliament to amend the constitution, or to elect him in the proper way. A convincing referendum result might have helped here. But neither event now looks particularly likely. One of the principal achievements of the Musharraferendum has been to forge a tactical alliance between two of Pakistan's bitterest enemies, both former prime ministers, Benazir Bhutto and Nawaz Sharif, as well as between the secular parties and moderate religious ones such as Jamaat-e-Islami, who usually despise each other. All resent what increasingly looks like an attempt by General Musharraf to prolong military rule in Pakistan indefinitely. The country's media, too, is universally hostile, where once it lavished praise.

Associates of the general are therefore desperately casting around for parliamentary support in the hope that they can unpick this alliance. They have succeeded in fragmenting the Pakistan Muslim League, led by Nawaz Sharif, the prime minister that the general toppled and later expelled. But much of the party has remained aloof. Instead, the general's men are looking for an understanding with the Pakistan People's Party, led by Benazir Bhutto, peculiar though that would be.

Sensing the sudden new strength of her position, Miss Bhutto has said that she will co-operate only if she can become prime minister for the third time, too large a pill for the general to swallow. This week, she upped the stakes again by saying that she will soon return from exile in Dubai to contest the October elections even if, as seems likely, she is arrested as soon as she lands. So uncertain is the political situation now that many observers doubt whether the October elections will be held at all. The presence on Pakistani soil of al-Qaeda terrorists, and Americans in hot pursuit of them, would seem to offer a perfect excuse for a postponement on the grounds of “national security”. The next six months look like being a bumpy ride.

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Japan

Message of the independents

May 2nd 2002
From The Economist print edition

They want reforms from Koizumi

Get article background

EPA

Wobble, wobble

WHILE Junichiro Koizumi was enjoying a four-nation tour of the region, voters at home inflicted more damage on his embattled government. On April 28th, only four weeks after being upset in a contest for mayor in Yokohama, the ruling coalition suffered two more defeats, losing an upper-house by-election and a race for a vacated governor's seat. Though they will not affect his party's hold on power, the losses may further hamstring Mr Koizumi, just as he prepares to launch a legislative offensive.

The defeats contrast starkly with Mr Koizumi's performance last July. Then, after only three months in office, he managed to reverse his Liberal Democratic Party's slide in the polls, leading it to a surprising victory in upper-house elections. Combined with his 80% popularity ratings, that success boosted his standing in the LDP, even though its power brokers only reluctantly tolerated his reformist message. Now, with his approval ratings cut in half, the voting booths have also turned against him.

Losing the upper-house seat in Niigata, to a candidate backed by three main opposition parties, seemed especially humiliating. The conservative stronghold was once the base of Kakuei Tanaka, a dominant populist prime minister in the 1970s. It is also the home of his daughter, Makiko Tanaka, an outspoken lower-house MP whose sacking from Mr Koizumi's cabinet in January triggered the plunge in his approval ratings. Her subsequent denunciations no doubt hurt the LDP in Niigata.

As in Yokohama, as well as this week's losing bid to hold the Tokushima governor's seat, exit polls in Niigata showed a sharp increase in the number of unaffiliated voters. In all three races, independents voted overwhelmingly against the ruling coalition's candidates. The same trend was apparent in this week's other by-election, for a lower-house seat in Wakayama, which the LDP won with lots of help from supporters of New Komeito, one of its two coalition partners.

Yet despite these losses, it will not be easy for Mr Koizumi's LDP rivals—who still matter more than the leaderless opposition—to exploit his weakness. Much of his fading popularity involves voters who like his anti-reform rivals even less. Yukio Hatoyama, who heads the largest opposition party, the Democrats, attributed this week's results not to Mr Koizumi's reform pledges, but rather to his failure to carry them out.

Replacing Mr Koizumi soon, therefore, would probably drive such voters even further from the LDP. But the prime minister's opponents can try to use this week's defeats to weaken him, and stall the few reforms he is still pushing. They may renew their calls for a cabinet reshuffle, which Mr Koizumi has sought to avoid, although in Australia this week he said he would consider the possibility. They may also call more loudly for the head of Taku Yamasaki, the LDP's secretary-general, who has become embroiled in a sex scandal and is now being blamed for the party's haphazard campaigns.

Mr Yamasaki is a potential Koizumi ally in the current Diet session, which is scheduled to close on June 19th. Before then, the prime minister wants to push through a series of bills that he hopes will revive his fortunes. These include measures to clarify the role of Japan's security forces, privatise parts of the

postal service, reform health care and overhaul the tax code.

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Cambodia

The boss's whims

May 2nd 2002 | PHNOM PENH
From The Economist print edition

Hun Sen's regal powers

NEXT year's national elections in Cambodia will, it seems, be delayed for a month to fit in with the plans of Hun Sen, the prime minister. Earlier this year, Mr Hun Sen moved local elections forward three weeks so that the digits of the date would add up to nine, his lucky number. The national assembly, at least, sanctioned those moves. It was not even consulted last year when Mr Hun Sen ordered all the country's karaoke bars to be shut down. Despite the loss of jobs entailed, and the arbitrary nature of the decision, few Cambodians dared protest. After almost 18 years as prime minister, Mr Hun Sen's hold on Cambodia seems practically unchallenged.

The prime minister seems to revel in this reputation. He once said to his biographer, “Among strongmen I am strong.” Earlier this year, he boasted to reporters about his power to choose Cambodia's next king, through his control of the council that makes the decision. He went on to assert that Sihanouk, the present king, had regained the throne after Cambodia's civil war only as a result of his support. He openly issues orders to judges, undermining the independence of the courts. When foreign monitors complained that the rescheduled local elections did not meet international standards, he declared, “International standards exist only in sports.” At those same elections, he regally declined to vote, declaring himself above mere party politics.

Yet Mr Hun Sen's rule is not exactly despotic. His Cambodian People's Party (CPP) governs in a coalition with the royalist FUNCINPEC party. The Sam Rainsy Party, a vocal opposition group, is a source of constant criticism, as is Cambodia's lively press. Elections, although marred by intimidation and violence, do at least take place. Foreign donors, who finance some 70% of Cambodia's budget, also provide a check on the government. Whatever the government's failings, Cambodians are aware that they are better off now than they have been at any point since civil war broke out in 1970.

Indeed, in some respects, the political climate has been improving of late. The number of opposition activists killed in elections has declined precipitously, from some 380 in 1993 to about 20 during this year's vote. Furthermore, that poll ended the CPP's monopoly on local government for the first time since the early 1980s. Even though the CPP won a landslide victory, a new law says that there should be opposition representatives on local councils.

Critics dismiss these changes as cosmetic: the central government, they point out, can keep local councils in line through its control of development spending. Anyway, they argue, Mr Hun Sen only allowed the elections to go ahead because he feels more secure now than ever before. Over the past two decades, he has methodically consolidated power. Having risen to the top of the CPP, he then out-manoeuvred Prince Ranariddh, the leader of FUNCINPEC, to claim the position of prime minister. Those who dissent, such as three CPP senators who recently queried a law increasing police powers, quickly find themselves out of a job.

But political savvy plays as big a role in Mr Hun Sen's ascendancy as strong-arm tactics. His village upbringing and rough-and-ready behaviour seem to appeal to Cambodians more than the French education and cosmopolitan airs of FUNCINPEC's leaders. By the same token, the Sam Rainsy Party's ideas about administrative reform and decentralisation seem far removed from the concerns of the 80% of Cambodians who live by farming or fishing. Even that order to ban karaoke bars, as arbitrary as it was, seems to have gone down well with many of Phnom Penh's housewives. The date of next year's elections may still be in doubt, but the result is certain.

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China

Down with the counterfeit Maoists

May 2nd 2002 | BEIJING
From The Economist print edition

Nepal's rebels are to blame

Get article background

CHINA is gloomy about the news from Nepal. It is not so much that the rebels there are killing people in large numbers. That is unfortunate, but sadly all life outside China is unfortunate. China is upset because the rebels call themselves Maoists, which it considers a slur on Mao Zedong, of immortal memory.

The Chinese foreign ministry has assured Nepal that China has never supported, or even had contact with, Nepal's rebels. It would never interfere in Nepal's affairs. Banish the thought. According to the Nepali embassy in Beijing, senior Chinese officials have not only expressed support for Nepal's battle against the rebels, but have also confessed their embarrassment at their awkward, unwanted association with the troublemakers.

Reuters

In fond memory

This is not the first time that China has had to endure what might be called counterfeit Maoism. Peru's Shining Path rebels called themselves Maoists and cheekily criticised China for selling out on Mao's ideals. To emphasise the point, they bombed the Chinese embassy in Lima in 1992.

Although these days China has moved on from its old communist ways, it remains fond of its founding dictator. Mao statues are kept in pristine condition. His face is on China's newly-designed paper currency. The Communist Party loyally sticks to his dictum that only one party can successfully run a state. Marx is still read, although these days not very enthusiastically. Anyone who damages Mao's memory, like those Nepalese rebels, had better watch out.

Anyone who damages Mao's memory had better watch out

Nepal says that the rebels are destroying water systems, telecoms equipment and other useful materials. Mao, as everyone knows, was never destructive. The rebels are also said to be attacking the rich in Mao's name. Class conflict is what matters. It is a travesty of his teaching, say his defenders. Did not Deng Xiaoping, a protégé of Mao, say that it was good to be rich?

Mao Zedong, as it happened, was fond of Nepal. In 1961 he invited King Mahendra to Beijing. “Your future is bright,” he predicted. Since then the monarchy has lost nearly all its powers. The country is in an economic mess and its politics are a nightmare. But then even the immortal Mao did not get everything right.

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About sponsorship

A new force in Central Asia

Americans in a strange land

May 2nd 2002 | BISHKEK
From The Economist print edition

Will intervention foster democracy?

Reuters

SIX months ago, Manas airport, near Bishkek, the capital of Kirgizstan, was as sleepy and dilapidated as the country itself. Now it buzzes with activity as soldiers, pilots and engineers from the United States and seven other countries erect tents, tinker with aircraft engines and equip bombers with their lethal payloads. Whether the Kirgiz realise it or not, a piece of military history is being made by the multi-national force of 1,900 (and rising) which has encamped at Manas airport and renamed their bit of it after Peter Ganci, the New York fire chief who died in last September's terrorist attack.

The tent city at Manas is engaged in a combat operation at present directed against the caves of Afghanistan, nearly 1,000km (620 miles) away. A dozen bombers, six American and six French, support the war against remnants of the Taliban regime and the al-Qaeda network. There are tanker aircraft supplied by Australia and France, and transporters from Spain, the Netherlands, Denmark and Norway. South Korea has sent a medical team. Despite the tents, the base has a far from makeshift look. It is under American commanders who seem to be quickly mastering the tricky art of integrating forces from a number of nations. Their boss, Donald Rumsfeld, the American defence secretary, flew in to give the troops a pep talk (picture above). The place where he spoke was given a homely touch with an enormous Stars and Stripes.

But marshalling its forces is just one of the challenges facing the American-led coalition as it hunkers down in Central Asia. The Americans, and to a lesser extent their western allies, are being drawn deep into the internal politics of a region with huge potential to change for better or worse. However diplomatic the westerners try to be, the arrival of their armies is transforming the scene.

Kirgizstan illustrates this in microcosm. The expenditure so far at Manas, just by the Americans, on items such as fuel, gravel, food and makeshift beds, is conservatively estimated at $16m: a tidy sum in a country of 4.9m where many people live in poverty. As Kirgizstan's president, Askar Akaev (once optimistically hailed as Central Asia's Thomas Jefferson because of his democratic words), becomes increasingly despotic, local people grumble that the Americans have boosted his power by buying fuel from businesses close to the seat of power. Americans retort that they have tried to spread their custom widely, while realising that, wherever they shop, they are bound

to make enemies.

Central Asia's growing strategic importance for America and its friends is also affecting the region's atmosphere in more subtle ways. At least in the short term, all the region's leaders feel their bargaining power with the West has palpably risen since the start of the war in Afghanistan. Human-rights campaigners and opposition politicians fear that they will be sidelined by the United States as it seeks to favour the local strongmen.

In fact, the American State Department does speak up when it feels that human rights and democratic procedures are being ignored. In Kirgizstan the American embassy gave at least moral support to an opposition activist who died on hunger strike in February. It protested over the detention in January of an opposition figure, Azimbek Beknazarov. The State Department has been pressing President Akaev to set up a fair inquiry into the killing by police of at least six unarmed demonstrators in March.

Neighbouring Uzbekistan is the other Central Asian state that has provided a base, at Khanabad, for western forces fighting in Afghanistan. It is the most populous state in the region, with the toughest army. The fact that the Uzbeks have enough security forces to police borders and suppress Islamist extremists makes them attractive partners for western forces. Or so say some American policymakers in Washington. They argue that America should back and harness the Uzbeks' regional ambitions. But for those who care about human rights, Uzbekistan is a nightmare; there are thousands of political prisoners.

Then there is Kazakhstan, a vast, energy-rich country where democracy is by no means a lost cause, but which has suffered some serious setbacks recently. The Kazakh opposition, like the opposition in Kirgizstan, is convinced that the high-handed behaviour of the rulers of Central Asia is a side-effect of the region's growing geopolitical importance. With no mean skill, the Kazakh president, Nursultan Nazarbaev, has used the Afghan war to play off the various bidders for influence in his country. America has obtained permission for its military aircraft to fly over Kazakhstan and to use Kazakh airfields for stopovers. Mr Nazarbaev's views will no doubt have been noted in connection with an American plan, disclosed this week, to maintain a long-term “footprint” in Central Asia. The Americans may be thinking of storing weapons in the region and of having access to airfields.

Donald Rumsfeld called on Mr Nazarbaev last weekend during his tour of the region. The defence secretary's trip has not been popular everywhere. A few days before Mr Rumsfeld's visit, Iran's President Muhammad Khatami had grumbled to Mr Nazarbaev that “the presence of any foreign power in any region causes concern”. But Mr Rumsfeld has a thick skin; and anyway he would have been given a kindly welcome by Mr Nazarbaev.

Russia, meanwhile, has offered a reminder that Kazakhstan, like the rest of Central Asia, used to be part of the Soviet empire. It has offered to train thousands of Kazakh army officers, and to sell arms at concessionary prices. Joint war games between Russia, Kazakhstan, Kirgizstan and Tajikistan (the members, along with Belarus and Armenia, of a collective-security pact) are becoming more frequent; Kazakhstan's vast firing ranges offer a perfect setting for mock warfare.

Much of the “collective security” was designed to defend the region against the Taliban and its Islamic allies. Mr Nazarbaev saw the Taliban-linked Islamists in Uzbekistan as a “direct and substantial threat” to Kazakhstan if the zealots had not been kicked out of Kabul, according to Marat Tazhin, the president's head of national security. Along with the Central Asian states, Russia, China and even Iran will agree that the defeat of the Taliban, the regional bogeyman, has taken a bit of heat out of the region's competition, the revived “great game”—a 19th-century term much used (and overused) in recent times.

Reuters

Under two flags

Nonetheless, Mr Tazhin and other Kazakh officials are at pains to stress that the threat from Afghanistan's former rulers (and related scourges, such as the huge stocks of heroin they accumulated) has yet to be vanquished. The security chief

believes that several thousand Taliban fighters may have escaped the latest battles; and argues that the new Afghan government, however worthy, may be too weak to stop the export of heroin, which mostly reaches Europe via Central Asia.

Even before the conflict in Afghanistan enhanced its importance, Kazakhstan was a force in regional politics. Last year, its GDP growth was nearly 13.2%. It has attracted well over $12 billion in foreign investment, nearly half from American oil companies. While there have been rumblings of economic nationalism from Kazakh politicians, the country is still committed to building a market economy. The American Commerce Department said recently that the country is doing some of the right things to build one.

As Kazakhstan's energy bonanza becomes more apparent, so too does the intensity of its internal infighting

But as Kazakhstan's energy bonanza becomes more apparent, so too does the intensity of its internal infighting—to the embarrassment of the country's western friends. President Nazarbaev has dealt ruthlessly with signs of dissent within the economic and political elite that formed a close-knit team during the early years of Kazakh independence. In March, Mukhtar Ablyazov, a former energy minister and businessman with substantial media interests, was jailed on vaguely formulated corruption charges. Another opposition figure, Galymzhan Zhakiyanov, took refuge in the French embassy after being accused of similar offences. He left the embassy after western ambassadors won an assurance that he would be kept under house arrest in Almaty. But the authorities broke their promise and moved him to the more remote Pavlodar—a move that drew diplomatic protests from several western countries. Nurbulat Masanov, an opponent of the regime, says the relatively mild western reaction to these events convinced the authorities that they could continue to squelch the opposition.

Both the jailed politicians were prominent members of Democratic Choice for Kazakhstan. Another source of democratic ideas is Akezhan Kazhegeldin, an exiled former prime minister. His web-sites are eagerly read by Kazakhs around the world but are jammed in his homeland.

Kasymzhomart Tokaev, the foreign minister, insists that the recent detentions are not harbingers of a one-party state: the government fully recognises the opposition's right to exist, and outsiders should not be over-hasty to interfere in judicial proceedings. But the arrests, and the closure of several media outlets, have led to what a western diplomat calls a “narrowing of the political space” at a time when it should be broadening. A former Kazakh minister, now a dissident, believes that westerners are naive about Central Asia.

> The West doesn't understand our leaders. They are old communists who talk about democracy when they are abroad but use a different language at home.

At least one of Mr Nazarbaev's aides has said publicly that the president will not be able to cope with an increasingly broad-based opposition by means of repression alone; some compromise will be needed if the country is to remain united and stable. Other observers, including some westerners, believe the president's crackdown may succeed, at least in the short term. They point to the absence of mass protest. The country, they point out, does not have the desperate poverty that has fuelled dissent in Kirgizstan.

Yerlan Karin, a rising star among Kazakhstan's geopolitical pundits, believes that as well as giving the region's governments a short-term boost, the war in Afghanistan has sharpened all Central Asia's pre-existing problems, from the burgeoning drug trade, to tension with China over agitation by nationalist Uighurs, based in Kazakhstan and active in nearby Xinjiang. He predicts that traditional tensions between Uzbeks and Kazakhs could resurface, as could competition for the water resources of Kirgizstan and Tajikistan.

Assuming he is even half-right, the Americans and their allies will be asking what sort of polity will be best placed to cope with these problems? A brittle, authoritarian state like Uzbekistan or a semi-democracy, as once seemed likely for Kirgizstan? As American pilots return to their new Central Asian bases after unloading their bombs on the Afghan mountainside, that is a problem that faces their political masters back home.

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Israel and the outside world

An international spectre over Sharon

May 2nd 2002 | JERUSALEM
From The Economist print edition

Although the government remains resolutely opposed to outside intervention, some Israelis are beginning to feel differently

Get article background

WITH apparent American acquiescence, Israel has seen off an international effort to examine its army's behaviour at the Jenin refugee camp during the invasion of the Palestinian territories last month. On May 1st Kofi Annan, the UN's secretary-general, announced that he was disbanding the fact-finding team he had set up, because of Israel's reversal of its earlier decision to co-operate. “The long shadow cast by recent events in the Jenin refugee camp will remain,” he said.

Israel still insisted that it had nothing to hide from an inquiry, despite the natural inference from its recalcitrance that it does. Ministers said they feared the “politicisation” of the process, which could result in individual soldiers or politicians being arraigned before an international court. And Israel's old dread of the conflict being “internationalised” is widely heard.

The ugliness and danger of the confrontation with the UN took Israeli ministers by surprise. They had been given to believe that a convenient deal had been worked out with the United States, whereby the siege of Yasser Arafat in his headquarters in Ramallah would be lifted in return for America ensuring that the Jenin inquiry would give Israel no grief. This was the backdrop to Israel's acceptance, on April 19th, of a Security Council resolution, drafted by America, empowering Mr Annan to set up the Jenin fact-finding team.

Mr Arafat was freed from his confinement on May 2nd (see article) after Ariel Sharon was subject to a brief and rare application of insistence by George Bush. Israel's prime minister then rammed the decision to end the siege through the full cabinet on April 28th. Six Palestinians, whose extradition Israel had been demanding as its latest condition for the release of Mr Arafat, would instead be held by the Palestinian Authority, under the supervision of British and American guards.

Cabinet hardliners had balked at this and the prime minister himself admitted it was a zig-zag: only a week before he had sworn “to go to elections if need be” over his insistence on the six men's extradition. In fact, the extradition demand was itself a zig-zag. Earlier, Israel had said it would lift the siege on Mr Arafat if the men were arrested by the Palestinian Authority. This they duly were, only to find themselves trapped, together with their leader, when Mr Sharon upped the ante.

Mr Sharon has been invited, as part of the general quid pro quo, to visit Washington next week. But the curious deal seems to have come nastily unstuck over the United Nations and its fact-finders.

Israel had challenged the impartiality and expertise of the team appointed by Mr Annan: Martti Ahtisaari, a former Finnish president; Sadako Ogata, a former UN high commissioner for refugees; and Cornelio Sommaruga, a former head of the International Committee of the Red Cross. It demanded that the team confine itself to Jenin and not extend its inquiry to the broader situation in the West Bank. At the same time it wanted the inquiry to extend backwards to the activities of terrorist groups in the Jenin camp before the Israeli assault. It also insisted that the team should not call Israeli witnesses independently, but only in co-ordination with the Israeli authorities.

Mr Annan was visibly distressed at the turn of events, insisting that the UN had done everything it could to satisfy Israel's various concerns. But Israel's justice minister, Meir Sheetrit, insisted that “The UN didn't keep its word...[the team's] verdict is a foregone conclusion.”

All week, recriminations have been flying around Israel's cabinet. David Levy, a former foreign minister, accused the present incumbent, Shimon Peres, of botching the negotiations with Mr Annan. Mr Peres, for his part, criticised the army's near-frantic anxieties over the fact-finding team. The chief of staff, General Shaul Mofaz, had reportedly threatened to resign should a single soldier be summoned to testify. And, most important, a senior general, Amos Gilad, gave warning that the fact-finders would “pave the way to the internationalisation of the conflict.”

Over the government's dead body, it would seem. But the bugbear of internationalisation is no longer regarded with universal Israeli terror. A poll taken last week by Tel Aviv University showed that about half of those asked would welcome outside involvement in settling a conflict that the partners are plainly unable to settle by themselves. More than one-third favoured the deployment of an armed international force, and a quarter said they supported the idea of a settlement imposed by the international community.

Internationalisation is still far from being an election-winner. But one politician who believes it could be is Shlomo Ben-Ami, who was foreign minister and Israel's chief negotiator under the Barak government. Mr Ben-Ami's formula is for “internationally supervised disengagement”. Israel would withdraw from some 90% of the territories to a temporary border line. The territories would be put under the control of an international body comprising America, the European Union and NATO. The temporary border would be policed by a multinational force, pending a final agreement along the lines of the one offered by Bill Clinton after the collapse of the Camp David summit. The international envelope, he argues, plus the international presence on the ground, would bring stability to the region.

Mr Ben-Ami is a lone voice, attacked from all points of the political compass. But his response to his numerous critics is cogent: “Has your plan worked better?”

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Palestine and the outside world

Arafat's great white hope

May 2nd 2002 | EAST JERUSALEM
From The Economist print edition

Yearning for foreigners to come and protect them

AP

An extempore trial that did the trick

Get article background

THE prospect of outside intervention, anathema to most Israelis, is a saving grace to Palestinians. On May 2nd Yasser Arafat was released from his imprisonment in Ramallah, courtesy of a model he wants applied throughout the occupied territories: the insertion of foreign security men. Any international force would have a dual function, protecting Israelis from terrorism as well as Palestinians from assault. But Mr Arafat sees it, above all, as shielding his regime and himself from an Israeli leader who is out to get both.

Five months ago, Mr Arafat was at a low ebb: confined by Israeli tanks to his presidential compound in Ramallah (and later squeezed into two rooms) and left to fester by much of Europe and the Arab world. Ariel Sharon had declared him “irrelevant” and the Bush administration was thinking of dumping him. Now he is “the most important leader in the Middle East”, as Saudi Arabia's crown prince, Abdullah, wryly told George Bush last week.

Thanks to an American-brokered deal, four of the six men holed up in Mr Arafat's compound, all of whom Israel wanted extradited, will serve the prison terms imposed on them by an improvised Palestinian court in a Palestinian Authority (PA) prison in Jericho, monitored, or, in Mr Arafat's parlance, “ protected”, by American and British security men. The other two are to be “detained” there.

The Palestinian leader is hoping for a similar way out of the crisis at Bethlehem, where a group of gunmen have taken refuge in the Church of the Nativity, along with scores of policemen, civilians and priests. Over the past week up to 60 people have been allowed out of the church. But Mr Arafat insists that the wanted men—the Israelis are now talking only of four or five—should not be jailed in Israel or exiled abroad but face prison terms, imposed by the Palestinian Authority, in Gaza “under international auspices”. He believes, or hopes, that Israel's stance on Bethlehem has been weakened by the Ramallah precedent, especially in the eyes of the Jerusalem churches, who have long sought international help to end the blockade on one of Christianity's holiest shrines.

They are not the only ones. In the past month, the UN, the European Union, Saudi Arabia and members of Israel's peace camp have all backed Mr Arafat's call for some form of outside presence in the occupied territories. “Left alone the parties will not be able to extricate themselves from the current impasse,” observes Kofi Annan, the UN's secretary-general.

Mr Arafat wants a multinational force empowered not only to monitor a ceasefire and an Israeli

withdrawal, but also to guarantee trade and movement between Palestinian areas, and the reconstruction of PA institutions destroyed by the army.

All this is resolutely opposed by Mr Sharon, who, the Palestinians believe, wants untrammelled military rule throughout the West Bank and Gaza to continue, plus a permanent siege on Palestinian cities, with occasional forays into them. On April 28th Israeli tanks rolled into Hebron, the one main West Bank town left untouched by Israel's latest offensive, after Palestinian guerrillas attacked a nearby settlement, killing four people, including a five-year-old girl.

Compared with the devastation visited on Jenin, Nablus and Ramallah, the invasion was small-scale. Resistance was light and the tanks left three days later. But the targets were the same: policemen were killed, hundreds of people were rounded up, PA institutions were raided, and 120,000 Palestinians were confined by a curfew. On May 1st, the army went into Gaza's Rafah refugee camp, leaving three Palestinians dead, including a baby girl. The next day the army entered Tulkarm.

If the Israeli army remains free to act in this way, it will spell the end of the PA. This is why Mr Arafat is hoping that the UN will press again for a probe into what happened in Jenin. There now appears little substance to Palestinian claims that a massacre occurred in the camp. But, according to human-rights and military experts, there is substance to the charge that the army committed grave breaches of humanitarian law, including the denial of medical treatment to the wounded, and the wanton destruction of civilian lives and property.

A mission authorised to look into this would almost certainly strengthen the call for a multinational force: as things are, the PA is unable to protect its civilians, and the Israeli army is disinclined to. This, basically, is why Mr Arafat wants the mission, and why Mr Sharon does not.

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Iran and America

Stop-start-stop talks

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Muddle and back-biting may have brought secret contacts to an end

EPA

Rafsanjani, man of secrets

THE man at the centre of Iran's latest, incoherent bid to improve its relations with the United States was in a roughly similar position 16 years ago. The results then were unfortunate. And the results of the present confused, back-biting process look like being no less futile.

In 1986, when Iran was in the middle of its long war with Iraq, Ali Akbar Hashemi Rafsanjani's political enemies gleefully disclosed his secret plan to buy arms from America, Iraq's off-stage protector. The plan was abandoned. But Mr Rafsanjani got his revenge when the main whistle-blower was executed. Now, once again, Mr Rafsanjani's opponents are accusing him, but in whispers this time, of communicating behind their backs with the enemy.

Anti-Americanism used to be intrinsic to Iran's national ideology. This is no longer as true as it was. The feeling has grown, particularly since George Bush included the country in his “axis of evil”, that Iran can no longer afford simply to glower at the United States. Ayatollah Ali Khamenei, Iran's supreme leader and the deciding voice on such crucial matters, has always been against direct talks. But he let it be known that he might no longer stand in the way of semi-official contacts, so long as they did not constitute “negotiations”.

The parliamentarians gathered round Iran's reform-minded president, Muhammad Khatami, decided to push more or less openly for better relations. But, in the middle of last month, rumours started to fly that officials from both countries had secretly met in Cyprus, or Geneva, or perhaps both. The reformists were furious at being left out: deputies and like-minded newspapers demanded that “transparency” be the watchword in dealings with America. In private, some parliamentarians put it about that allies of Mr Rafsanjani, his son among them, arranged and perhaps attended the meetings. Moreover, they say, these Rafsanjani men did so without the prior knowledge of Kamal Kharrazi, the foreign minister. Mr Kharrazi may shortly be hauled before parliament.

If he is, he will also be grilled on the mysterious sacking of his nephew, Sadeq Kharrazi, from his position as deputy foreign minister. This happened at the time when the rumour mills started grinding in earnest. Sadeq Kharrazi is said to have headed a team, set up by Mr Khamenei, to look into the possible repercussions of starting talks with America. Yet, according to one account, he was sacked on the orders of Mr Khamenei. Others say his uncle pushed him out. In the company of friends, Mr Kharrazi does not deny that he attended one of the controversial meetings. Whoever sacked him, it seems likely that it was because he exceeded his brief.

Clearly, parts of Iran's fractured political establishment are all too ready to sabotage the efforts of any other part to win the glory that might possibly emanate from opening a dialogue with America—so long, that is, as Iran succeeds in enhancing its prestige in the process. Both reformists and conservatives are said to be alarmed by the suggestion that Mr Rafsanjani was trying hard for the prize. Although his influence still weighs heavier than his official post as head of a mediating body, Mr Rafsanjani is by no means the titan he was before and during his eight-year presidency that ended in 1997. He performed embarrassingly at the last parliamentary election, and his enemies are keen to prevent his rehabilitation.

America, itself, did little to usher in friendlier times. Last month, the Senate passed a bill that seeks to make it harder for Iranian citizens, among others, to get American visas. The State Department has refused three requests from Iran's ambassador at the United Nations for permission to travel outside

New York. And American customs officials recently subjected a respected Iranian film maker to a rather undignified search.

In any event, the whole muddled, stop-and-start enterprise seemed to have crashed to a stop on May 1st when Mr Khamenei ruled out any talks in a speech that slammed America in old-fashioned style. The supreme leader repeated his call for an oil embargo, praised Palestinian suicide bombers and said that negotiations were a rotten idea as America would use them to impose its demands. Given Iran's, and Mr Rafsanjani's, way of doing things, this does not necessarily rule out secret contacts. But it makes them less likely.

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Mali's election

Desert democracy

May 2nd 2002 | BAMAKO
From The Economist print edition

Pluralism thrives, messily

AP

Actually, there were lots of candidates

A CARNIVAL atmosphere prevailed, as candidates handed out T-shirts, sugar, tea and cash. Mali's presidential election on April 28th was not without its flaws, but with 24 candidates vying to replace the outgoing president, Alpha Oumar Konaré, no one can argue that Malians have not been given a choice. Since Mr Konaré has served two five-year terms, the constitution says he must step down. And so he did, without fuss.

The campaign was peaceful, if somewhat disorganised. Mali is huge, half desert, sparsely populated and poor, so there were some logistical problems. For many voters, the nearest polling station was a 100km (60-mile) walk over blistering sand. Despite the use of mobile ballot boxes, ferried by jeep and camel, turnout was low. Many people complained that they were unable to vote because they had not received voting cards. The candidates included several no-hopers and one clown: Habib Dembele, a professional comedian, whose slogan was “Choose the one who'll make you laugh; not the ones who'll make you cry”. One woman tried to stand, but was scratched when her husband refused to pay her $7,000 deposit.

There were three serious candidates. General Amadou Toumani Touré, a former head of state, is widely revered for having led a coup in 1991 that ended two decades of dictatorial rule by General Moussa Traoré. He then presided over a peaceful transition to democracy. The ruling ADEMA party's man, Soumali Cissé, a former finance minister, buzzed into remote regions by helicopter, impressing some, but causing others to flee in terror at the sandstorms his rotors whipped up. Ibrahim Boubacar Keita, a former prime minister, enjoys the support of the country's imams, who have been calling for a moral clean-up, and even hinting that Mali should adopt *sharia* law. This is the first time that religion has featured so prominently during a Malian election. Although 95% of Malians are Muslim, the state is firmly secular.

Results were supposed to be announced on Tuesday night, but were not. One excuse, greeted with scepticism, was that the only technician who knew how to work the election computer had been injured in a car crash. Early results suggested that it would be a close race, with no one winning an outright majority. If not, the two best-placed candidates will take part in a run-off on May 12th.

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South Africa's universities

Rumbles on campus

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From The Economist print edition

How to get more, and better, graduates

CAN Mark Shuttleworth, the South African who this week is enjoying a rather expensive holiday in space, tempt more students to study science? After his return to earth on May 5th, Mr Shuttleworth plans to tour South Africa to convince the young that science is hip. He will have his work cut out. Although employers yearn for maths and science graduates, students prefer softer disciplines such as public administration and the humanities. Only 15% of youngsters, half the rate of a rich country like Britain, make it to campus, and only one in six of these actually earns a degree, says Kader Asmal, the education minister. For black South Africans, the figures are even worse than these averages.

The problem starts in schools, where exam results are poor, not least because a whole generation of students boycotted classes to protest against apartheid. But the universities' misuse of resources plays its part. “We are not getting value for money,” says Mr Asmal.

And quite a lot of money is being spent: a fifth of the budget went last year on education. The country spent about the same in the apartheid years, although it was all wildly skewed towards white South Africans. Today a useful 700m rand ($66m) a year goes on higher education alone. But this is split between 36 universities and technikons, many of them small and run-down, with overlapping courses and remote campuses.

Good universities outside the cities, such as Eastern Cape's Fort Hare university, find it hard to attract capable students or lecturers. Just 532 of its 7,000 students graduated this year, only a handful of them with a master's degree or doctorate. Its prestigious alumni—who include Nelson Mandela, Oliver Tambo, Govan Mbeki and Robert Mugabe—would be shocked.

The solution is simple, suggested a working group that looked at higher education earlier this year. Use the resources more effectively. Under apartheid there were separate institutes for whites and blacks, often near each other. Many of these should now be merged. And others, particularly in the old black homelands, should be closed: a finger points, for instance, at the indebted, poorly-attended University of Transkei. As many as 15 institutions could go without damage, said Saki Macozoma, a businessman who led the working group.

Unsurprisingly, that provoked fierce protests. Staff, seeing their jobs vanishing, complained that the mostly-white universities would survive unscathed. Why, they asked, should only black-dominated ones be chopped? Because, explained Mr Macozoma, “the brightest and the best black students have already voted with their feet”, fleeing the old black colleges. Mr Asmal agrees. This week the minister took his plans for radical change, including mergers and closures, to the cabinet.

But the reforms will be difficult to push through. Some ministers are reluctant to see their old student homes disappear, and the cabinet postponed taking a decision for two weeks. Mr Asmal is already trapped in one contentious attempt to bring together three distance-learning universities. He had hoped that this merger would go smoothly, but reluctant university staff are being awkward, despite legal threats and warnings that subsidies will be cut. This bodes ill for the wider, necessary, changes to a higher-education system that still needs a lot more than Mr Shuttleworth's goodwill to become world class.

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Zimbabwe's press

Arresting them

May 2nd 2002
From The Economist print edition

Including our correspondent

ANDREW MELDRUM, *The Economist*'s correspondent in Zimbabwe, was arrested on May 1st. He was charged for an article he wrote last week for the *Guardian*, a British newspaper, in which he reported allegations that followers of President Robert Mugabe had beheaded Brandina Tadyanemhandu, a mother of eight, whom they suspected of supporting the opposition. The story had first appeared in a local paper, the *Daily News*, in a report by Lloyd Mudiwa and Collin Chiwanza. They were arrested on April 30th and apparently charged under a new law that prescribes jail terms of up to two years for publishing falsehoods.

Several people have been killed in political violence this year, but Ms Tadyanemhandu may not have been one of them. A man claiming to be her husband described her murder to the *Daily News* in chilling detail. But when, after publishing it, the *Daily News* asked to visit her grave, he was unable to show it to them. On April 27th, the paper said it seemed to have been misled and published an apology to the ruling party. The apology was not accepted.

The state-owned *Herald* accused the *Daily News* of conducting a vicious campaign to tarnish the government's image. In the past, it has accused Mr Meldrum, an American citizen who has lived in Zimbabwe for 22 years, of being a liar, a saboteur and an associate of terrorists. He is none of these; on the contrary, he is a courageous, hard-working and reliable reporter.

In an unrelated development, Mr Mugabe announced on April 30th that food shortages had reduced much of the country to a “state of disaster”. He blamed the weather.

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Anti-Semitism in Europe

Is it really rising?

May 2nd 2002
From The Economist print edition

Growing hostility to Israel, and Islamic attacks on Jewish targets in Europe, do not mean that old-style anti-Semitism is back

Get article background

IT HAS become an article of faith in much of the American press that anti-Semitism in Europe is surging and that age-old hatred of Jews, after a post-Holocaust period of silence and shame, is once again coming to the surface. Why?

First, there has been a sharp increase in anti-Jewish vandalism (against synagogues, for instance), mainly but not only in France. Second, criticism of the Israeli government's Palestinian policy, expressed across Europe's political spectrum, has become so widespread and often so fierce that some Jews in Europe feel it is spilling over into hostility to them as people, for seeking to defend Israel's actions. Third, a French populist, Jean-Marie Le Pen, who has expressed anti-Semitism in the past, has rocketed into prominence by reaching the final round of France's presidential election. Fourth, far-right parties elsewhere in Europe, from Austria, Italy, and Denmark to Poland and Romania, some with anti-Semitic ingredients or histories, continue to make a splash, sometimes even joining ruling coalitions.

Does this mean that anti-Semitism of a deep-seated kind is rising or that Jewish fears of a return to the horrors of the 1930s are well founded? No. The fears are understandable but should not be exaggerated.

True, since the Palestinians' second *intifada* against Israel began in autumn 2000 and, more notably, since the uprising intensified this year, synagogues and other Jewish buildings have been attacked in Belgium, Britain and especially in France. A German rabbi, after two recent street assaults on Jews (by youngsters of Arab appearance), has advised his brethren in Germany not to display signs of their faith for fear of being beaten up. This week a synagogue in London was ransacked at night.

France, in particular, is singled out as fundamentally anti-Semitic, partly because of its long-standing friendship with Arab states at the expense of Israel. A well-known British journalist says that anti-Semitism is rising in Britain's “media and political establishment”, especially on the left. “This wave of anti-Semitism across Europe”, says an Israeli editor, “is unprecedented since the second world war.”

Take France first. As far as anybody knows, the perpetrators of nearly all the attacks on Jewish property there have been disaffected young men from among France's 4m-5m Muslims. Few have been attributed to the sort of white extremist drawn to Mr Le Pen. A skilful opportunist who changes with the populist wind, he now hurls most of his abuse at France's Muslims, not its Jews. Indeed, a leading French Jew laments that quite a few of his co-religionists voted last month for Mr Le Pen. There is scant evidence that many of the misguided 17% who followed suit were animated primarily by anti-Semitism.

French racial prejudice, including anti-Semitism, is commoner than it should be, with a long and dishonourable history (see table). But opinion polls in France suggest that personal hostility to Jews, as opposed to the Israelis' government, is neither widespread nor increasing. Jews in France, who number some 600,000 (the biggest such community in Western Europe), are on the whole respected, professionally successful, socially

assimilated and well represented in politics. Pollsters suggest that anti-Semitism is only slightly more common among the mainstream right than on the left. In the current government, Jews hold several important portfolios (for finance, European affairs, education and health, among others). The Socialists' secretary-general is Jewish. Few analysts put Mr Le Pen's success down even partly to anti-Semitism. French Jews themselves are divided over whether, French Muslims apart, anti-Semitism is rising.

In Britain, too, Jews, who (loosely defined) number around 300,000, have prospered in all walks of life, suffering few of the impedimenta that slowed advancement in the past. Politically once mostly on the left, many Jews moved to the right during Margaret Thatcher's and John Major's time in power. Britons of Jewish background were appointed to such top jobs as chancellor of the exchequer and secretary for defence, foreign and home affairs.

With Tony Blair, who is popular in Israel, many Jews have returned to a Labour Party that has shifted to the centre. Britons of Jewish descent are well represented in Parliament, and better than ever in the now largely appointed House of Lords, where they hold around a tenth of the seats. Such success has bred no discernible resentment.

The most striking phenomenon, however, is the steady shift of sympathy away from Israel, especially on the left. Last month an opinion poll (see chart) showed that only 14% said they were more sympathetic to Israel than to the Palestinian Authority, while 28% sympathised more with the Palestinians; Britons overwhelmingly and in equal measure disliked Ariel Sharon, Israel's prime minister, and the Palestinians' Yasser Arafat.

Some of our best friends...

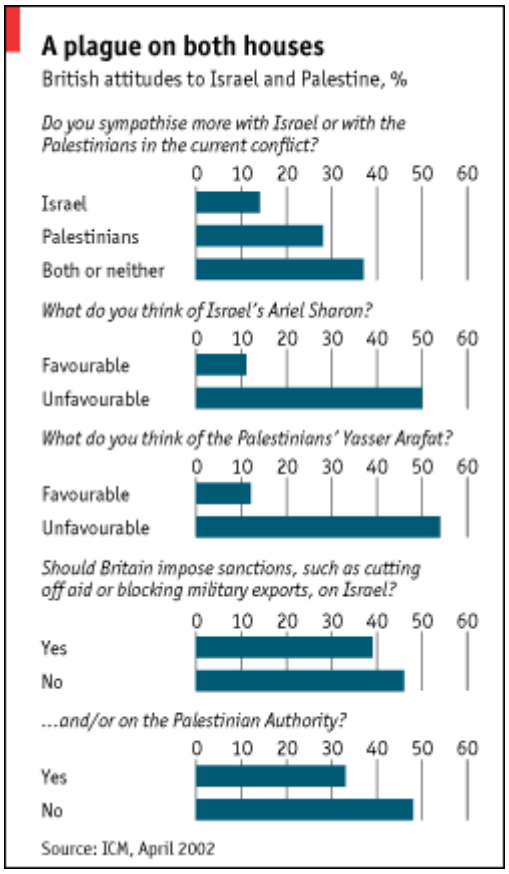
What the French think of their Jewish compatriots
%, Feb 2002

	Yes	No
Jews have too much influence in business and finance		
All	22	77
Socialists	21	79
Communists	24	76
Mainstream right	29	71
All the right*	33	67
Of Arab descent	35	65
Practising Catholics	14	85
Jews have too much influence in the media	21	79
A French Jew has more in common with a French person of another religion than with an Israeli Jew	63	29
Could you ever envisage living with a Jewish person?	89	11
Recent attacks on synagogues are scandalous and the culprits should be punished	87	
If Jews supported Israel less, these attacks wouldn't have happened	11	
There's too much talk about the Holocaust	5	94†
Making anti-Semitic graffiti is a serious crime	97	3
Joking about gas chambers is seriously wrong	91	9
Mocking someone wearing a kippa or Star of David is seriously wrong	90	10
Insulting a policeman is seriously wrong	87	13
Making jokes about Jews is seriously wrong	66	34

*Including National Front
†52% said "not enough"; 42% said "the right amount"
Sources: UEJF; SOS Racisme; Sofres

A plague on both houses

British attitudes to Israel and Palestine, %



Source: ICM, April 2002

Criticism of Israel's government does not, of course, equal anti-Semitism. But many Jews are horrified by what they see as a new and wilfully false moral equivalence between the Israelis and the Palestinians and a tone of anti-Israeli hostility that has become so strident as to smell of anti-Semitism. Many are particularly upset by what they consider to be the editorial virulence and one-sided reporting of two quality newspapers read mainly by leftish Britons, the *Guardian* and the *Independent*.

Jews yes, Sharon no

Germany is different. Most Germans, in politics or ordinary life, remain plainly wary of expressing

outright hostility to Israel's government. Few dare to contradict the leader of Germany's Jewish community, which has grown in the past decade from around 30,000 to more than 130,000 thanks to immigration from the former Soviet Union, when he states that anti-Semitism is a spiralling threat. In fact, though far-right violence has risen in the past few years (and dropped a bit last year), it is mainly directed against Muslims from North Africa and Turkey, not against Jews.

But German opinion on Israel has shifted. Politicians on the left and the right have openly criticised Mr Sharon's tactics. Norbert Blüm, a former Christian Democratic minister, says Israel is conducting a “war of annihilation”. The current aid minister has called Israeli troops' behaviour “shocking”. Karl Lamers, a leading Christian Democrat, says that Israeli policy could “lead to a catastrophe”.

Elsewhere in Western Europe there has been a rise in attacks on Jewish property, again often by young Muslims. At the same time there has been increasingly outspoken criticism of Israeli policies across the political spectrum. It is this mix of physical assaults by thugs, mainly on property, with verbal assaults on Israel by more respectable citizens that has made many of Europe's Jews feel vulnerable in general.

It is in Central and Eastern Europe that fears of anti-Semitism have previously deserved more attention. Russia still has the largest Jewish population—more than 1m—in Europe, and one of the grimmest historical records of persecution, from the time of the tsars and during the Soviet era. In the first post-communist general election, in 1993, an anti-Semite, Vladimir Zhirinovsky, won the most party-list seats, with nearly 23% of the vote.

Russian populists habitually blame Jews for the widening post-communist gap between rich and poor, noting that most of the “oligarchs”, the dozen-odd influential tycoons who became hugely rich after communism collapsed, are of Jewish background. Fraudulent documents, such as “The Protocols of the Elders of Zion” that propagate the idea of a world Jewish conspiracy, circulate widely and are even quoted approvingly by populist politicians and some Orthodox churchmen. But as Russia has become steadier, anti-Semites' political hopes have drooped.

Bad news from Poland

Ultra-nationalists elsewhere in the ex-communist zone have played the anti-Semitic card, often reminding voters of the prominent part played by Jews both in the Bolshevik revolution in Russia and in the communist takeovers in such countries as Poland and Hungary after the second world war. Anti-Semites did quite well on the fringes in the last general election in Poland (where only 7,000 Jews now live); one blatantly anti-Semitic party took 8% of the vote. Another that carried a whiff of it did slightly better.

In last month's general election in Hungary, the outgoing ruling party on the nationalist right was criticised for failing to denounce an anti-Semitic party more wholeheartedly lest it might need to co-operate with it in parliament. In the event, the overt anti-Semites got only 4% of the vote—and no seats.

In sum, anti-Semites have made occasional sallies in the past decade in Central Europe. Crude anti-Semitic discourse is less thoroughly frowned upon than it is in Western Europe. A strain of anti-Semitism lingers in the Orthodox churches. But on the whole anti-Semites have lost ground as people have grown more prosperous.

More worried in the west

In any event, it is in the more mature democracies farther west that Jews have been especially shocked by what they call the new anti-Semitism. But the phenomenon, such as it is, is hard to define. That sacrilegious vandalism has increased is disturbing. That the anti-immigrant far right is strong (though far from dominant) rightly worries minorities, not just Jews.

Growing hostility to Israel is a more complex trait. Anyone defending Israel's government nowadays is bound to have a harder time of it. But that does not itself mean that heavily anti-Semitic sentiment goes beyond a very small proportion of Europeans.

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France and Jean-Marie Le Pen

Why he has his admirers

May 2nd 2002 | CARPENTRAS
From The Economist print edition

In some provincial parts of France, the far right may have momentum

Get article background

AP

Berets and baguettes for Le Pen too

“IF WE get to 30% of the vote, the political class is screwed,” proclaims the Carpentras lawyer in unlawyerly language. “They're in a system sheltered from reality. They never have to look for a job. But we're in touch with people's real worries: crime, taxes and safeguarding the French personality.”

The “we” is the extreme-right National Front, whose leader, Jean-Marie Le Pen, will this weekend, in a run-off vote, try to deny the centre-right Jacques Chirac a second term as France's president. The lawyer is Guy Macary, who may become his town's member of parliament after next month's general election. The “political class” is code for an establishment ranging from the Communists to the Gaullists that for the past 30 years has more or less managed to keep Mr Le Pen and followers such as Maître Macary in quarantine.

Yet in the presidential election's first round, on April 21st, that quarantine was breached. Mr Le Pen horrified most of France (and indeed the world) by gaining almost 17% of the vote, enough to knock out 14 other candidates, including the Socialist prime minister, Lionel Jospin, and so become the sole challenger on May 5th to Mr Chirac, who came an unimpressive first with less than 20%. In Mr Macary's Carpentras, in the Vaucluse department of sunny Provence in the south, Mr Le Pen topped the list with 32%; in the Vaucluse as a whole his victory score was 26%, with Mr Chirac, on 17%, a distant second.

But why, of all France's regions, is Provence, so favoured by American tourists and North European pensioners, such a stronghold for the extreme right, both Mr Le Pen's party and its breakaway rival, the National Republican Movement (MNR)? Most plainly, it is where many of the rightists' obsessions are most on show: high rates of crime and unemployment, and a large population of brown-skinned immigrants and their French-born descendants. A resident of Provence, for example, has roughly twice the chance of being pickpocketed or burgled as a householder in peaceful Brittany in the north-west, and is more likely to be out of work: Provence's jobless rate is about 13%, whereas Brittany's matches the national average of 9%. Moreover, if a victim of crime is white, he is all too quick to assume the culprit is North African by birth or ancestry.

The assumption may well be wrong. Jacky Allègre, the Vaucluse representative of MRAP, a France-wide body fighting racism, admits that the poor and brown-skinned are more likely to be the criminals but points out that a lot of the “burglary specialists” are from the former Yugoslavia. Jean-Claude Andrieu, a Liberal Democrat who has been mayor of Carpentras since 1987, says “there are no big gangs here—we just have a problem with 40 or 50 young people.”

Maybe so, but there are only 78 police to fight crime in a town of 28,000 and in adjacent Monteux, with its 10,000 residents. Moreover, youngsters cannot be detained and the courts are clogged, so, as the mayor asks, “What can the police do?”

The Le Pen answer is to add another 200,000 prison places across France; bring back the death penalty; lower the age of criminal responsibility; end legal immigration; expel illegal immigrants; and restrict citizenship to the children of French citizens or “to those who deserve it”. In other words, make life difficult for the country's North African population, including those who make up a tenth of Carpentras's

residents. In the Sport Bar, just outside the walls of the old city and with an exclusively Arab clientele, 25-year-old French-born Kamal is already resigned: “It's hard to get a job, and it's hard just getting into a disco. And then there are the teenage *beurs* [children of Arab immigrants] making things worse with their stupidities.”

But did those voters in sleepy Carpentras who chose Mr Le Pen on April 21st really endorse his programme? Emotionally, probably yes. Provence is full of families with Italian and Spanish names from previous waves of immigration. As Mr Allègre sees it, “the old generation of former Italians and Spaniards are the most racist of the lot.” Add to them the *pieds noirs*, white European settlers, like Mr Macary, who fled to France when Algeria became independent 40 years ago. Add the unruliness of many *beur* youngsters, who, French-born and educated, feel no respect for their illiterate parents, whose main skill as immigrants was often to pick grapes. The result is a solid core of support for the anti-Europe, anti-immigrant, authoritarian Mr Le Pen.

Losing could still be victorious

Hence his belief that the wind is behind him. The goal is not to astound all the pundits by becoming president but to keep the momentum going into the two-round general election on June 9th and 16th. That is why the Front will consider anything over 30% for Mr Le Pen on May 5th a victory. After all, virtually every party (except for Bruno Mégret's MNR and the Trotskyite Arlette Laguiller's Workers' Struggle) has told people to vote for Mr Chirac in a “common front against the Front”. The defeated Mr Jospin could not bear to mention Mr Chirac by name but said all Socialists should “by their vote reject the extreme right and its danger for our country and for those who live in it.”

But what if Mr Le Pen's momentum endures? Only after the general election of 1986, the only one to be held with a system of proportional representation, did the Front get a real foothold in the 577-strong National Assembly, their 10% of the vote winning them 35 seats. In the last general election, in 1997, they managed 15% of the vote but only one seat, which was promptly taken away for financial irregularities.

Next month, however, the Front may do rather better. If the pundits, extrapolating from the April 21st presidential figures, are correct, the extreme right may be a deciding factor in 319 of mainland France's 566 constituencies and might win ten of them. That hardly spells power or much national influence for the Front, though it might prompt the mainstream right to pander to those whose feelings Mr Le Pen taps into. In any event, Mr Macary is smiling: his part of the Vaucluse is among the ten.

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A populist Russian general

His time had gone

May 2nd 2002 | MOSCOW
From The Economist print edition

Alexander Lebed's kind of Russian politics already looked out of date

Reuters

Brave man, poor politician

NOT so many years ago it looked like the future face of Russian politics: a brave and honest former soldier with experience in ending civil wars, moving first to a top job in the Kremlin and then to run a rich region. As it turned out, General Alexander Lebed was looking thoroughly out of place in President Vladimir Putin's Russia when he died this week in a helicopter crash in his Siberian fief of Krasnoyarsk.

The simple virtues Mr Lebed stood for, Russia turned out not to need. He made his name in 1992 as a blunt instrument of peacemaking during a brief but savage civil war between Slav- and Romanian-speakers in Moldova, a former Soviet republic. He followed that up by brokering a peace deal that ended the first war in Chechnya, an independence-seeking statelet on Russia's southern fringe. His reward was a stint as security chief in President Boris Yeltsin's Kremlin. Then he was elected to govern a Siberian region rich in aluminium and nickel.

During those wobbly years, it seemed evident that the army needed to be humoured and that a retired general would be ideal for the job. Mr Lebed was that rare Russian bird: a senior officer more or less in favour of democracy. Ordinary Russians liked his earthy, soldierly style. At times he seemed a possible successor to Mr Yeltsin—or a possible rival. Kremlin fixers, particularly Boris Berezovsky, a magnate now in exile in London, were quick to get their hooks into Mr Lebed, whose military training seemed to have left out much of any ability to judge character or motive. Indeed, spectacularly bad organisation and poor judgment proved his undoing.

His attempt to consolidate his fief in Krasnoyarsk was a shambles. He immediately fell foul of the local metals barons (an admittedly venal bunch) but failed to produce an attractive alternative. The fashionable new values in Mr Putin's Russia are efficiency, organisation and accountability, words that never sprang to mind with reference to Mr Lebed, whose strength was a knack for grabbing headlines with a few gruff and heartfelt words. The other cardinal virtue in Mr Putin's world is an ability to build a strong team, which the president spends a lot of time doing, with increasing success. By contrast, Mr Lebed changed his advisers like socks, to little effect.

His one sure virtue, an ability to bash warlords' heads together to stop wars, is not in much demand. The Moldovan conflict is frozen rather than over; the Kremlin may like it that way. The war in Chechnya, despite last week's news of the apparent assassination by a Russian agent of Khattab, a Saudi-born rebel commander, sputters bloodily on. The Kremlin, alas, has shown no public interest so far in the bold but painful kind of compromise that Mr Lebed was able to make in 1996.

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The European Union and Britain

Presidential pique

May 2nd 2002 | BRUSSELS
From The Economist print edition

The EU's Romano Prodi annoys Britain

PA

Prodi measuring up Blair's Britain

Get article background

TAKE two was a shade less offensive than take one. Even so, the speech delivered in Britain on April 29th by Romano Prodi, the European Commission's president, riled Tony Blair's government. Mr Prodi attacked one of the revered pillars of British foreign policy, the notion of a "special relationship" with the United States, which he said Britain saw as "giving it extra leverage in the world...I don't think that is the case." But that was mild compared to an earlier draft of the speech in which he mockingly compared the United Kingdom's relationship with the United States to that of the smaller wheel on a penny-farthing bicycle.

Any illusion that Mr Prodi warmly admires Mr Blair can now be laid to rest. In reality, it has been an open secret in Brussels for a while that the commission's boss is infuriated by Mr Blair's role in blocking tax harmonisation, by his vacillation over whether Britain should join Europe's single currency and by what Mr Prodi sees as Britain's refusal to put its full weight behind a European foreign policy—the issue that most concerns him right now.

For Mr Prodi is clearly worried that the United States will attack Iraq, against the wishes of much of the EU, and that Britain will back America. The British are sticking to their view that Mr Blair can play a uniquely valuable part as a trusted and moderating influence on the United States. They also say that, when it comes to the Israeli-Palestinian conflict at least, Mr Prodi is out of step with European sentiment, not Britain. "He was pushing for sanctions against Israel but got no support from the EU's member states, not even from France," says a senior British official.

Behind the immediate dog-fight over foreign policy lies a broader issue. For those who want Europe to integrate faster, forging a much stronger and more unified EU foreign and defence policy is the next big item on their agenda. It is very much an aim of most of those at the constitutional convention on Europe's future, now under way in Brussels. But they know too that such ambitions cannot be achieved without Britain's co-operation, because it has the best army in Europe and the closest ties, military ones included, to America. As a senior EU man puts it: "You can't have a common foreign and defence policy without Britain, any more than you could have had a common currency without the Germans." Hence the worry that in a crisis the British will ultimately always side with the Americans.

Mr Blair, however, refuses to accept that there is any choice to be made between the EU and the United States. He wants simultaneously to stay close to the Americans, to build up an EU foreign policy and to guide Britain into the euro. The last task, British officials lament, is made a lot harder by cack-handed interventions by Mr Prodi. Indeed they used their strongest word of condemnation for Mr Prodi's recent speech. It was "unhelpful".

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Charlemagne

Dieter Kastrup, a diplomatic German

May 2nd 2002
From The Economist print edition

But not one whose advice will soften the German chancellor's foreign-policy stance

“A COW that is worked hard, and that gives good milk, must sometimes also be stroked.” Thus Gerhard Schröder, busy again this week nagging members of the European Commission about the need to take Germany's economic and industrial interests to heart if his country is to go on producing the goodies that finance a quarter of the European Union's budget.

When Dieter Kastrup took over as Mr Schröder's foreign policy adviser in January, pundits predicted the return of a more modest German approach to the world. A former ambassador to the United Nations, he looked just the opposite of his precedessor, Michael Steiner, who had to quit after a less than diplomatic exchange with a German airman on a Moscow runway. Mr Steiner was impulsive, extrovert, brash; the tall, silver-haired Mr Kastrup was cool, reserved, polite—the perfect gentleman.

Born just after the second world war, Mr Steiner, a student rebel in 1968, was a leading advocate of a more assertive, self-confident school of German diplomacy; a “grown-up” and reunited Germany, he argued, was entitled to push openly and, as the chancellor put it, “without complexes” for its national interests, like any other country. Mr Kastrup, born in 1937, belonged to an older school of German diplomacy, bearing the stamp of Hans-Dietrich Genscher, foreign minister from 1974 to 1992. To this school, the “land of the Holocaust” might pursue its own interests behind the scenes, but must project itself as a junior partner on the world stage, usually deferring to its European allies.

Yet four months after the arrival of Mr Kastrup, described by Mr Schröder as “one of Germany's most experienced and outstanding diplomats”, there is little sign of a return to any greater modesty. On the contrary. Not since 1945 has Germany put itself about so boldly or uninhibitedly. Rarely has it talked so loud—or been listened to so attentively. Not since 1945 have so many German soldiers, over 10,000, been so scattered around the world, or German leadership sought after in military affairs.

It is only seven years since the federal republic first deployed troops outside its own frontiers. Since then, and mostly since Mr Schröder became chancellor in 1998, it has sent them right and left. German soldiers were sent into combat for the first time since 1945 in Kosovo in 1999. Mr Schröder has now pledged 3,900 to the “war on terror” in Afghanistan and elsewhere, and 100 of Germany's elite KSK troops have been helping hunt down al-Qaeda. Germany is one of the main participants in the 4,500-strong international peacekeeping force in Kabul, and was repeatedly pressed—albeit it declined, citing lack of resources—by both the Americans and the interim Afghan administration to take over leadership of the force, in succession to the British.

In Macedonia, Germany has been in full command of NATO forces since last autumn. Mr Steiner has re-emerged as the UN's proconsul in Kosovo. Reportedly, the Americans would like Germany to lead an international naval force off the Horn of Africa. Some 200 Germans specialised in nuclear, biological and chemical warfare are stationed in Kuwait; they will stay there even if the Americans attack Iraq, Mr Schröder has said, for all his strong misgivings about such a strike. He has even refused to rule out possible German participation in any force that might be sent to keep a future peace between Israelis and Palestinians. Small wonder that many Germans are shaking their heads in amazed disbelief, and some with alarm or horror.

And the supposedly restraining hand of Mr Kastrup in all this? “Don't overestimate an adviser's role,” he says. “It is not my job to change foreign policy. I simply give advice; it is up to the boss to decide.” He was indeed influenced by Mr Genscher's cautious approach to German diplomacy, says Mr Kastrup, but he insists that he sees nothing wrong today in a more assertive attitude. “We have to live up to our new responsibilities, while continuing to bear in mind the burdens of our past.” That is the new buzz word in

German foreign policy: “responsibility”. Do not suspect Germany of seeking greater influence and power: “That would be neither accurate nor fair,” Mr Kastrup protests.

What, then, does Germany think it is up to in the European Union? Since the start of the year, it has been complaining ever more bitterly about its supposedly unfair treatment by the Eurocrats. First there was a public spat over the European Commission's threatened reprimand to it for Germany's mounting public deficit. Then came a whole series of angry protests: against the commission's plans to cut industrial subsidies, liberalise car sales, crack down on carbon-dioxide emissions, ease restrictions on mergers and acquisitions, phase out coal subsidies, toughen environmental standards in the chemical industry—all, in German eyes, to the detriment of German competitiveness. The commission was ignoring the unique situation of Europe's biggest industrial power, Mr Schröder grumbled. It could not on the one hand admonish Germany for its meagre growth and high deficit, while on the other clobbering its industry, the main motor of its economy, and demanding that it pay ever more into the EU's ever-gaping coffers.

Votes have something to do with it too

Some of this stridency can be put down to the fact that this is election year in Germany and Mr Schröder faces a tough fight. It does him no harm to present himself as the doughty defender of national interests in Brussels, or to offload some of the blame for Germany's economic woes on to meddlers there. At a dinner in Brussels this week with Romano Prodi, president of the commission, and other leading commissioners, the chancellor and the Eurocrats agreed to take the heat out of their discord. Still, Mr Schröder has a point. A cow does need the occasional stroke (or whatever today's dairy farmers do) if it is to continue to produce at its peak potential. As Mr Kastrup would agree. Indeed, for all the differences of style, the content of his advice is probably little different from that of his predecessor.

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Local government

Tony's watching you

May 2nd 2002 | LIVERPOOL
From The Economist print edition

Fiscal handcuffs are one way of keeping local government under control. But Liverpool's story suggests that elections are a better way

COUNCIL workers in Liverpool have been busy this week answering a lot of questions from puzzled people. When you have been used to voting by writing a cross on a piece of paper, how exactly do you use a mobile phone or the Internet to vote? All sorts of odd voting methods have been tried in lots of places this week. Sheffield City Council even provided an electronic voting kiosk close to the World Snooker Championships being held in the city so local fans could vote and watch their favourite sport.

The government hopes that these and other experiments in different voting methods will have persuaded more people than usual to cast a ballot in the English local council elections on May 2nd. Voting was still going on as *The Economist* went to press, but there was no great expectation of a surge in interest. In the past few decades, voters' enthusiasm for local elections has dwindled to the point that only around 30% turn out, slightly less than half the number who vote at general elections. In many cities, turn-out is down to 25%. British turn-out is dismal compared to that in mainland Europe (see chart).

The downward trend suggests that it is more than the bother of having to trudge along to the local school or church hall which makes people shun the polling booth. Voters are not stupid. They are more likely to vote when much hangs on the outcome of the election. And they know that little depends on the results of British local government elections. Local government in Britain raises only 4% of the total tax take, compared to 32% in Denmark, 12% in America, 10% in France and 8% in Germany. Some 75% of local government spending in Britain is provided by central government, compared to 50% in France and 25% in America.

Central government determines how much to give councils through the “standard spending assessment”, a formula which, according to the Audit Commission, is more complex than that used anywhere else in the world, with the possible exception of Australia. The formula has grown so vast that nobody now knows how many variables it includes. According to Chris Game, of the Institute of Local Government Studies at Birmingham University, “the idea that central government should try to specify how each and every local authority should spend its money is met with

incredulity abroad.”

A recent White Paper on local government finance proposes a new, unified system to monitor councils' performance. The plethora of performance indicators and inspections to which councils are subjected will be fused together into one gigantic performance indicator to categorise councils under four headings—high-performing, striving, coasting, and low-performing. The best councils will get a bit more freedom over spending, but the worst will find Whitehall camped on its doorstep, ready to take over its functions or hand them over to someone else.

All this is motivated by the government's belief that councils cannot be trusted. But by depriving councils of power, government has cut the link between taxation and representation, and thus reduced the incentive for councils to spend wisely and for voters to get rid of them when they don't.

Even so, in a roundabout way, democracy seems slowly to be doing the trick. Voters treat local elections more as an opportunity for a mid-term protest vote than as anything to do with their local area, so the Liberal Democrats have benefited in recent years, as voters have punished the Tories and Labour in turn. Lib Dems in power for decades are as bad as councils in any other one-party town. But, in cities where they are in competition with Labour, they have tended to run things rather well.

Liverpool, for example, was a byword for all that was worst in local government when the Trots ran it in the 1980s. But since the Lib Dems took over in 1998, 70% of the council's performance indicators have improved markedly. This year, the administration cut council taxes after freezing them for the previous three years.

The council is getting a reputation for efficiency. It boasts the biggest municipal call centre in the country, which has been much admired by ministers. It operates 24 hours a day, taking 30,000 calls a week. This week it was also fielding inquiries about electronic voting from Sheffield which has seen similar service improvements, although not the council tax cuts, since the Lib Dems took charge in 1999, ending the days of the Socialist Republic of South Yorkshire.

The government's zeal for making councils perform better is understandable. Education, for instance, is a local function, and the government rightly believes that better schooling is crucial to Britain's prospects. It does not trust councils with something so important, and so tries to control schools from the centre.

But these days, local government does not deserve the contempt with which it is treated. Most councils are better than they were; and, if they had more power, the voters would get out to the polls to make sure they got better still.

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Gangs

Wild things

May 2nd 2002
From The Economist print edition

Not quite Los Angeles, yet

THERE may be nothing new under the sun, but there is always something new in the *Sun*. Last week, two teenage brothers were acquitted of murdering Damilola Taylor, a ten-year-old boy who bled to death in a stairwell in Peckham, south London. After the verdict, the newspapers revealed the brothers' barely credible history of proven and alleged criminality, and came up with a new adjective—"feral"—to describe such voraciously criminal youths, said to be prowling Britain's inner cities in delinquent gangs. How new a phenomenon are they?

Not long ago, the members of one especially nasty gang, which terrorised Wood Green, north London, were caught and imprisoned. The neighbourhood, though, has form: in August 1919, several hundred youths attacked the police in the "The Battle of Wood Green". After the second world war, Londoners fretted about gangs prowling the rubble with switchblades and chains; they were superseded by mods, rockers and skinheads. Youths have always congregated on council estates and caused trouble. As Ben Bowling, of King's College, London, says, "every generation of pundits and politicians rediscovers the problem of degenerate youth".

Nevertheless, Commander Andy Baker, of London's Metropolitan Police, says that today's teenage gangs display some new and worrying characteristics—such as the involvement of pre-teen children; and a propensity to commit more extreme violence than their predecessors (including "juking", whereby victims are stabbed in the thighs or buttocks). Lord Warner, chairman of the Youth Justice Board, points out that street robbery is inherently more collaborative than the burglary and car-theft once preferred by juvenile criminals. Britain has never had formalised gangs on the Los Angeles model, with their own uniforms, languages and constitutions (not to mention the guns). But Mr Baker fears that British gangs might be evolving in that direction.

The explanations cited for this degenerating degeneracy are predictable, and depressingly intractable: educational failure; broken and workless families, and the fracturing of working-class communities. The government's hyperactive announcement of policies to combat it hardly inspires confidence. The latest idea, mooted amid the hullabaloo following last week's acquittal, is for the parents of persistent truants to forfeit their child benefit. Around 50,000 children play truant every day in England, often with the collusion of parents; many fill the time nefariously. But making their families poorer is hardly the answer.

Happily, as well as offering a premonition of doom, America offers some possible solutions. Last week, the government also announced plans for police officers to be attached to schools in troubled areas—an idea already tried in some British schools, and similar to an American anti-gang initiative, known as GREAT, which began in Phoenix, Arizona in 1992, and has since spread across the country. Dan Grant, the police chief of Brownstown, Michigan—a town perilously close to the ganglands of Detroit—says that GREAT has helped to eliminate the drive-by shootings and other gang-related afflictions from which Brownstown used to suffer. As well as strangling gang recruitment, it also inculcated trust in the police—lacking in London, where, the Met believes, many Peckham youngsters know who killed Taylor but won't tell.

Some American-influenced schemes have already been set up to retrieve British youngsters who have strayed. For example, "Youth at Risk" has provided short residential shocks and extended mentoring for, among others, members of the Sutton Burglary Posse, an astonishingly prolific group of young burglars—achieving big reductions in offending and improvements in school attendance. Ben Rose, the scheme's founder, says the basic idea is to help young people understand that a life of crime is not inevitable. Such remedies are of course expensive—except when you consider the alternatives.

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House prices

Bust ahead

May 2nd 2002
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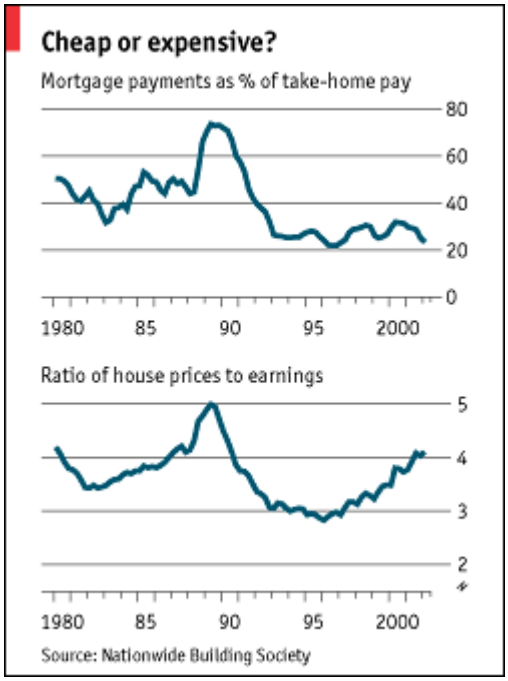
It's happy hour again in the housing market. Wait for the hangover

IN THE past thirty years, there have been three rollercoaster rides of boom and bust in the housing market, culminating in the dizzy rise of the late 1980s and the sickening slump of the early 1990s. Now the rollercoaster is up and away again.



House prices jumped by 3.4% in April, the biggest monthly increase since the boom of the late 1980s, according to the Nationwide Building Society. House prices rose by 16.5% in the year to April, a rate exceeded in only one month in the past ten years.

Whenever a bubble develops in an asset market, there are always apologists to justify it. So with today's housing market. Two arguments are being used to defend current valuations. The first highlights the clash between long-term demographic pressures and the constrictions of planning policy. The resulting imbalance between demand and supply is especially acute in London and other southern regions where it is causing a long-term increase in the real cost of housing.

The second rationale is that purchasing a house remains surprisingly affordable. According to the Nationwide, initial mortgage payments on a new loan currently represent about 25% of take-home pay. This is a modest outlay by comparison with the past cost of servicing a loan.

Both arguments are flawed. Whatever the long-term prospects for the housing market, particularly in the south of England, prices can overshoot, just as they have done in the past. The decline in economy-wide inflation has brought down interest payments, but borrowers also have to repay their mortgages. When interest payments comprised a higher proportion of earnings, as in the late 1980s, inflation swiftly eroded the burden of debt, which allowed house purchasers to trade up in the market after a few years. Now debt has to be paid back in honest money.

A more sophisticated justification for the housing boom is that it represents the first phase of an adjustment to low inflation. The initial impact is to boost the market because of lower borrowing costs at the start of a mortgage. However, the persistence of debt will subsequently constrain homebuyers' ability to trade up in the market. Alex Bannister, group economist at the Nationwide, says, “It is at this point that reality will sink in and house-price growth will move down to a slower trend of around 4-5%.” Reassuringly, he claims that this moment of truth is still some two to three years away and that the housing market will remain buoyant in the months ahead.

The more that house prices surge ahead, the less realistic this sanguine scenario looks. The boom is already stretching valuations. A time-honoured gauge of the sustainable level of house prices is the ratio of average house prices to average earnings. After April's jump in prices, this ratio is well above its long-run average and only about 15% less than its all-time peak in 1989. A calculation by Capital Economics, an economic consultancy, which uses the government's rather than Nationwide's index of house prices, estimates that the ratio is now only 2% less than the peak of 1989. “The longer the house price boom continues, the more likely a crash becomes,” warns Roger Bootle of Capital Economics.

In the past, property bubbles were eventually pricked by higher interest rates. But the economy has stalled in the past six months, so the Bank of England is reluctant to tighten monetary policy. A speech on April 29th by David Clementi, deputy governor of the Bank, suggests that rates are not going up in a hurry. Mr Clementi sought to calm nerves about an overheating housing market by denying there was a bubble.

Even so, the financial markets still expect the Bank to raise rates later this year. When it does, this may start to curb speculative interest in the housing market, which has centred on the buy-to-let private rental market. By the middle of last year, there were already over 130,000 loans supporting this market. “In the late 1980s, people invested and speculated with their own home, now they are doing so through buy-to-let,” says Richard Donnell, a director at FPDSavills, a property consultancy. The market, which is predominantly in London and the south-east, is potentially fragile. Yields have fallen sharply and letting agents are reporting an over-supply of properties on their books.

The rollercoaster may still be on the way up. But ahead lies another fall. The faster house prices rise over the next few months, the steeper that eventual decline will be.

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Twinning

Pas de deux

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British towns are looking for exotic new friends

ROMANO PRODI, president of the European Commission, complained this week that Britain is not keen enough on Europe. To judge by one measure, he may be right. For more than 50 years, town twinning has been a popular way for Britons to acknowledge their European buddies. But now they are looking further afield.

Twinning took off after the second world war. Links were mostly forged with France (wartime ties) and with Germany (reconciliation). There was another surge when Britain joined the EEC. Some old twins are going strong. Bristol still swaps students, music groups and sports teams with Hanover, its twin since 1947. Others, though, have lapsed. And in many places more exotic names have sprung up by the roadside. From the 1950s to the 1980s about 5% of twinned towns linked up with non-Europeans. In the 1990s, the figure was more like a quarter. Including informal arrangements, it is probably now a half.

Towns with lots of immigrants see twinning as a way to maintain cultural ties. Hounslow, a London borough, is twinned with Lahore in Pakistan, and linked with Jalandhar in India. Liverpool and Manchester, which have big Chinese communities, are twinned with Shanghai and Wuhan.

Other places have come up with economic, humanitarian, or simply social reasons to make far-flung friends. Essex, a region with few Chinese residents, has established a strong link with Jiangsu Province. Bristol is now twinned with towns in Mozambique and Nicaragua as well as in Europe. And in Iganga, Uganda, a garbage truck bears the name of Daventry, the English town which provided the vehicle; exchange visits and links between voluntary and school groups have followed.

The European Commission takes twinning seriously and funds new projects. Along with the Foreign Office, it is promoting links with eastern and central Europe. Despite Britain's wanderlust, it has had some success: Poland is now Britain's fourth most popular twinning partner. Twinning, the commission believes, is a valuable tool for promoting European integration.

Tell that to the residents of Sandown, a holiday resort on the Isle of Wight which is twinned with the French town of Tonnay-Charante. Last year Jean-Phillipe Harmant, president for life of the Tonnay-Charante twinning association and a part-time fireman, bussed 50 fellow firefighters over to stay with Sandown residents. Diana Drayton, the head of the Sandown twinning committee, says most of them disappeared to London and were never seen again. This year Mr Harmant announced he was en route with another 50 guests. Ms Drayton resigned; Mr Harmant and his friends went to Spain.

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ITV

Buying time

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Will merging solve Carlton and Granada's problems?

THE ritual denials are being issued. The old rivalries persist. Carlton and Granada, the two main holders of the ITV television franchises, have freed themselves from ITV Digital, the loss-making pay-TV operation they created and which was switched off this week. But it is no secret that they will revive their merger plan. Although talks were called off in February, Charles Allen, Granada's chairman, declared only a month later that restructuring at ITV "logically and inevitably leads towards a single ITV company". Will a combination of the two, however, put an end to their troubles?

In the past, the chief obstacle to a merger has been regulation: no company may control more than 15% of the national television audience, or hold both of the two London franchises. Tessa Jowell, the media minister, has said that she will lift those rules, and is expected to do so in her draft Communications bill, due to be published next week.

This will not remove all barriers to their union, however. Carlton and Granada sell 56% of the country's TV advertising, so they will still be subject to scrutiny on competition grounds.

Yet the government's mood has changed. It recognises that consolidation is necessary if Britain's commercial television industry is to stay competitive. No other European country has split its top commercial channel between two competing franchise-holders. And the growth of pay-TV channels is anyway shrinking ITV's share in ad revenues. It is likely that a technical solution—a single ITV retaining two separate ad-sales houses, for instance—will be found to soothe regulatory fears, at least temporarily.

Even if it is approved, the creation of a single ITV company may only buy time for Carlton and Granada. A merger would deliver some immediate gains. Cost savings could amount to £50m over the first two years of a merger, according to Mathew Horsman at Investec, an investment bank. In the longer run, however, lurk broader structural problems.

First, despite recent troubles in the pay-TV industry, the drift towards multi-channel television continues. Pay-TV viewers between the ages of 16 and 34 spend more than 45% of their time glued to non-terrestrial channels; children are not far behind. To hang on to mass audiences, broadcasters need more than ever to create "event TV": shows that get people talking, grab tabloid headlines and boost ratings.

ITV achieved this recently with "Pop Idol", a talent contest judged by viewers, which attracted more young voters than the general election. Even "The Forsyte Saga", a BBC-style costume drama, is currently trouncing BBC1 in the Sunday night ratings. The ITV companies plan to invest more in programming, but such blockbuster shows are hard to replicate.

Second, battling to keep a dwindling audience is not in itself an exciting business proposition. A merged ITV, worth about £5 billion, would rank as only a middling media business in Europe, smaller than Italy's Mediaset, and a midget next to France's Vivendi or Germany's Bertelsmann. Particularly at a time when programming costs are escalating, it is hard to compete without size. Could a single ITV expand overseas?

Unlikely. It is not clear that there are many economies of scale in broadcasting across Europe's multilingual borders: the making and buying of programmes and the sale of TV advertising airtime remains highly compartmentalised by country. Strict European broadcasting regulations present yet another problem. Besides, the only existing pan-European broadcaster, Bertelsmann's RTL, is more likely to be keen on buying into ITV than the other way round.

Lastly, the collapse of ITV Digital has shut off one means of diversifying the business. Currently, advertising accounts for the bulk of ITV's turnover. Ad revenues, though, were down 12% in the six months to March compared with the same period last year. How have other broadcasters sought new revenue streams? TF1, France's top commercial broadcaster, has launched thematic subscription channels. But ITV will take no comfort from its other source of diversification: TF1 invested in a pay-TV operation, TPS, conceived as precisely the logical complement to its broadcast operation that Carlton and Granada had imagined ITV Digital would be.

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Tobacco

Smoking for England

May 2nd 2002
From The Economist print edition

Kicking the habit is good for you and the NHS. Right?

PITY the British smoker: cast on to the pavement like his American counterpart to face the elements, just to light up. Still, at least the government is doing its bit to help British addicts quit. The National Health Service last month approved Zyban, a new anti-smoking drug, and has been increasingly pushing its smoking cessation services. The government has also made a pack of smokes a more expensive pleasure in Britain than in almost any other country.

High cigarette taxes are supposed to wean Britons off tobacco and raise money for the NHS. Smoking-related ailments are a heavy burden on the NHS, the government says, estimated at around £1.5 billion a year in England. Smokers, the argument runs, should pay for the costs of their guilty pleasures. Higher taxes are supposed to encourage quitting, thus sparing both the ex-smokers and the NHS'S finances.

But perhaps the government should think again. Nearly a decade ago, tobacco taxes were scrutinised by American economists, as Congress cast about for ways of paying for its own ambitious, but ultimately doomed, overhaul of health care. They found that a decline in smoking would indeed reduce the costs of treating smokers' ailments.

However, it would also have less obvious effects. Smokers tend to die younger than do their abstemious peers, by nearly a decade. Non-smokers require, on average, even greater spending than smokers for other chronic ailments. So by reducing smokers' life expectancy, tobacco saves government money. Similarly, last year a fancy consultancy commissioned by Philip Morris studied the effects of smoking on the Czech Republic's finances. It found that premature deaths from smoking saved the government around £100m in 1999.

In Britain, where the state pays a greater share of health costs, the savings are bound to be higher than in America—even without considering the pension benefits that go unclaimed by dead puffers. So the lower classes, who do most of the smoking, are probably subsidising the health care of the better-off, who have largely given up.

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Government and IT

Your health depends on it

May 2nd 2002
From The Economist print edition

Another government IT disaster bodes ill for public-service reform

IF GORDON BROWN is still basking in the apparently widespread approval for his plans to revive the National Health Service with a massive transfusion of cash, a small item of seemingly unrelated news last week, reported in *Computer Weekly*, should worry him. A leaked memo from the Lord Chancellor's department indicated that Libra, a £319m IT project designed to link magistrates' courts with other organisations, such as the police, customs and the Crown Prosecution Service, was on the brink of collapse. Libra's problems are the latest in a long list of government IT horror stories (see table) which bode ill for the government's ambitions. NHS reforms, like all public service improvements, depend heavily on IT.

IT isn't working

Government IT project failures

Department	Project	IT supplier	What went wrong
Benefits Agency/Post Office	Benefit payments	Fujitsu/ICL	Abandoned after three years at cost of £1bn
Lord Chancellor's	Processing cases	Fujitsu/ICL	Failure of core case-working software costing £178m
Home Office	Immigration applications	Siemens	Abandoned at a cost of £77m when system failed to cope with the number of applications
Ministry of Defence	Classified information	Unknown	Abandoned after mounting security and compatibility problems, £41m written off
Home Office	Passport agency	Siemens	Passport application processing went from ten days to eight weeks, adding £40m
Contributions Agency	National Insurance	Accenture	1,900 separate failures resulted in compensation to 400,000 people, costing £38m
Inland Revenue	Various	EDS	Rising costs led to more than double the envisaged spend, adding £1.4bn

According to *Computer Weekly*'s Tony Collins, Libra went wrong from the start. Fujitsu, the contractor, was the only bidder for the work in 1997 after EDS, a big systems integrator that works with many departments (it is near the end of a ten-year outsourcing deal with the Inland Revenue that cost £2.4 billion rather than the originally envisaged £1 billion), had been disqualified from the bidding process.

But the big problem was that the agencies that work with the Lord Chancellor's department generate hundreds of different forms of all shapes and sizes. That's no trouble for people, but it is for machines, which need standardised templates and a shared data model. Little effort was spent standardising those forms. So, instead of adapting a piece of off-the-shelf software, Fujitsu had to build one from scratch. Fujitsu was happy because it would make more money; the Lord Chancellor's department was happy because it wouldn't have to change the way people worked in the agencies that deal with magistrates' courts.

But building software from scratch makes it likelier that things will go wrong. A trial run of Libra in Sussex threw up huge problems; but despite the warning signs, Libra rolled merrily on until last month.

Unless something can be salvaged from the mess, the consequences for the criminal justice system are dire. For many, especially remand prisoners, it will mean justice delayed and therefore denied. Others

will become the victims of criminals who re-offend before their cases are heard.

In fairness, private sector IT projects go wrong too, and only a few match the scale and complexity of, for instance, NIRS, the national insurance system, which has to deal with 65m accounts and more than 100m online transactions each year. The government, as well as official watchdogs such as the parliamentary accounts committee (PAC) and the national audit office, is also well aware of why it is that so many of its own IT projects go wrong.

There is now a raft of Whitehall-wide guidelines aimed at trying to learn from past mistakes. These include: the need for projects to be “owned” by one responsible and competent individual; recognition of the fact that projects are often over-ambitious and need to be broken down into bite-sized chunks; the realisation that the way people work has to change when new technology is installed; the importance of drawing up contracts that have the right mix of sticks and carrots to make vendors deliver on their promises; and, above all, the need for clear and precisely-defined objectives.

All perfectly sensible, but probably not a lot more useful than most “motherhood” statements. The reasons why government IT projects have such an appalling record lie deep within public sector culture. Because civil servants are used to focusing on saving money rather than on spending it to increase efficiency, contracts are invariably awarded on the basis of price rather than value, quality or past performance. Because the civil service is used to exercising tight control, tenders put out under the private finance initiative can run to a thousand pages. Not only are they absurdly over-prescriptive, but they are often out of date by the time work gets under way.

Strong civil service unions make it difficult to change the way departments work. As the PAC's Richard Bacon puts it: “The system rewards those who don't rock the boat.” Private companies can also more easily redeploy people whose jobs are automated away than can departments and agencies whose remit is set by law.

The civil service's habits of excessive secrecy and respect for hierarchy don't help, either. Regaining control of rogue projects requires openness and flexibility. And government often lacks the right people because it won't pay enough, even though hiring project managers with the right technical skills might save millions of pounds later on.

Derek Wanless, the former NatWest chief executive whose report on the NHS provided the justification for Mr Brown's largesse, says that the health service needs to more than double its IT spending to around £2.5 billion a year. “Without a major advance in the effective use of ICT (and this is a clear risk given the scale of such an undertaking) the health service will find it increasingly difficult to deliver the high-quality service which the public will demand. This is a major priority which will have a crucial impact on the health service over future years.” Confident?

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Bagehot

Whatever works

May 2nd 2002
From The Economist print edition

Tony Blair has prospered by being Britain's first post-ideological prime minister. So far

IT'S some recognition of Tony Blair's achievements that most of the inevitable crop of articles written this week to mark the anniversary of that seismic electoral event five years ago assume they are delivering only a half-term report on his government. It is true that one or two have noted that Mr Blair is looking tireder and older, suggesting (hopefully) that this is a sure sign that the government has already begun the downward part of its trajectory. More plausibly, the prime minister's sleep is disturbed by the permanent jet lag that comes with excessive foreign travel and the demands of baby Leo.

Although the past year has been Mr Blair's most difficult since becoming prime minister (and a few still persist in believing he will one day give way to Gordon Brown), he shows every sign of being at least as keen as his sovereign, who jauntily began her own anniversary celebrations this week, to carry on reigning. Not only does Mr Blair like being prime minister; more importantly, most people seem to like him being prime minister as well. Although the latest polls indicate that Mr Blair is less trusted than before—the effect of the steady stream of sleaze stories over recent months—he has still been more popular and for longer than any prime minister since polling began.

Mirror, mirror on the wall

Although the government Mr Blair heads has been at least adequately competent, that is only part of the explanation for New Labour's continuing ascendancy. The underlying reason, and the cause of much frustration for the Tories, is that this government may more closely reflect the country it governs than any of its predecessors. As the political historian, Lord Skidelsky, has observed: “Tony Blair leads Britain's first truly representative government. In it are mirrored the strengths and weaknesses, hopes and fears of modern Britain. Its very mediocrity of language and ambition reflects the land it governs—a second-class country with a great past, a comfortable present, and modest prospects.” That last bit may be a little harsh, but when people look at this government, they do seem to see themselves: practical, sentimental, well-meaning, resolutely non-ideological and more than a little hazy on detail.

But if Mr Blair's genius has been his ability to articulate a form of post-ideological politics for a post-ideological age, exemplified by his defiant agnosticism about where the boundaries should lie between the public and private sectors and encapsulated in the phrase “whatever works”, it is also potentially a source of weakness and confusion. According to the now familiar “narrative” of New Labour, the first task was to transform the old Labour Party, both by turning it into an electorally efficient machine and by repudiating an idea of socialism based on equality of outcome; the second was to establish as a fact that Labour could be trusted in office not to mess things up; the third phase, the one on which the government has now embarked, is to deliver those improvements to the main public services that it has repeatedly promised. What is already clear, however, is that the success of the first part of the New Labour story provides no clue to what will come next.

The contrast with the government of Mrs Thatcher is instructive. Like Mr Blair, her first term was dedicated, albeit under very much more difficult circumstances, to building a platform. In her case, it was a launching-pad for the microeconomic reforms that cumulatively transformed the British economy. These policies—from privatisations to a host of measures designed to increase labour-market flexibility—were informed by a consistent view of the way the world worked. In other words, Mrs Thatcher was never without an ideological compass which, at least until her last two years in power, provided a steadfast guide to direction and action. Mr Blair (and even his more wonkishly-inclined friend at the Treasury) is like most normal people: he not only lacks such a compass, but wouldn't know what to do with it if he had one. When Mr Brown says that he sees no conflict in wishing to combine the best of an

American-style enterprise economy with European social solidarity, he is not just repeating some third-way mantra; he is making a statement about the value of ideology.

Instead of having what political scientists would call a theory of causation, Mr Blair favours something his earnest young advisers like to describe as “evidence-based” policymaking. This is a rather grander way of saying “whatever works”. Above all, it seems to mean picking up good ideas from countries you admire and trying to apply them to Britain. According to one of those advisers, with the exception of America, nearly all the countries that are around or above Britain in the international competitiveness league tables (the Scandinavians, Canada, Singapore, the Netherlands) combine exactly the kind of economic dynamism with the extensive and relatively efficient public sectors that New Labour wants. They, rather than American neo-liberalism or German-style stakeholder capitalism, are Mr Blair's model and inspiration.

The trouble with this magpie approach to policymaking is that it produces plenty of ideas, but no single big idea. Mr Blair would deny this. He would say that his government does have a big idea: to bring excellence and choice to the public services through a combination of increased funding and (New Labour buzz-word meaning competition) contestability. Services, such as health and education, will still be universal and tax-funded, but their delivery will increasingly depend on competition between providers from either the public or the private sector.

But something vital is missing: a clear and coherent view of what is done best by whom. No doubt Mr Blair has an open mind about it. However, an open mind can only get you so far. If the next five years are not to end in failure, Mr Blair must find—and learn to use—an ideological compass of his own.

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Model makers

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Corbis

For two decades, the Netherlands' "polder model" seemed to be working miracles. Now the shine has worn off. But the Dutch still have plenty going for them, argues John Peet

DRIVE a few kilometres north-east out of Amsterdam and you gradually notice that the landscape has changed. It is, inevitably, flat. But the fields, roads and ditches start to look almost too manicured; the settlements and towns too planned; and the trees become notable mostly for their absence. And then you realise that this area was until recently under water: until 1968, in fact, when it was drained to become Flevoland, the largest and newest Dutch "polder" (land reclaimed from the sea), situated at the foot of the Ijsselmeer.

Every schoolchild knows that water is critical to the Netherlands. Fully one-quarter of the country is below sea level, and much of it has been reclaimed over the centuries: as people say, "God made the world, but the Dutch made the Netherlands." Although the landscape looks solid enough today, dangers still lurk. As recently as 1953 the southern dikes were breached, inundating part of Zeeland and killing some 2,000 people. One of the more poignant places in the country is just south-east of Dordrecht, where on November 18th 1421 the dikes gave way and a medieval polder was flooded, with the loss of 73 villages and as many as 100,000 lives. This former polder has never been reclaimed: today its marshes and lakes make up the Biesbosch national park.

Water has been crucial to Dutch survival in war, too: whenever the country has been under threat, the last-ditch option, literally, has been to open the sluices. A turning-point in the nascent Dutch republic's revolt against Spanish rule came with a breach of the dikes that made possible the relief of Leiden. A century later, the same weapon held off the marauding soldiers of Louis XIV. It did not, however, keep out Napoleon, who contemptuously referred to the country as "alluvium deposited by the principal rivers of my empire" and unceremoniously abolished the 300-year-old republic. (The Netherlands is a rare example of a country that has switched from republic to monarchy, rather than the other way round.)

For the Dutch, water has a significance beyond the past. To take on a project as ambitious as the making of a polder requires two important attributes, besides capital and property rights. One is a strong governing authority; the other an ingrained habit of co-operation and consultation. It is these twin attributes that lie at the heart of the "polder model", the popular name for the Dutch practice of policymaking by consensus between government, employers and trade unions.

Dutch disease, miracle cure

Over the past decade, the polder model has attracted a lot of interest from abroad. Much of Europe has been struggling with high unemployment, low growth, rigid labour markets, excessive regulation and an overgenerous welfare state. The obvious and unflattering comparison has been with the United States, whose economy has repeatedly proved itself more flexible, more innovative and more resilient than Europe's. Yet not all of Europe has fallen behind. Several smaller countries, such as Denmark and Ireland, have prospered mightily. And so too has the Netherlands.

As the 1990s progressed, the Netherlands seemed to have hit on a winning combination of high growth, low unemployment, low inflation and a budget surplus—all without dismantling its generous welfare system. Such luminaries as Bill Clinton and Tony Blair hailed Wim Kok, the Dutch prime minister, as an unsung hero of their “third way”. Mr Kok's government resigned last month, ahead of the election later this month, after a report criticised the Dutch over the 1995 Srebrenica massacre. But the true legacy of his eight years in office will be the revival of the country's economic confidence.

AP

Kok took the rap

The Netherlands has, admittedly, long been prosperous: in the 17th century, the Dutch republic was twice as rich as any rival. But by the 19th century it had fallen back; it came late to industrialisation, and well into the 20th century was still primarily agrarian and less well off than its neighbours. After the dark period of German occupation in the second world war, however, the Netherlands quickly joined in Europe's economic revival, and in 1959 it received a boost from the discovery of large gas reserves off its northern coast.

Yet things soon started to go wrong. Gas fuelled a massive expansion of public spending, especially the construction of a ludicrously generous welfare state. By pushing up the exchange rate, gas also helped to eat away at Dutch competitiveness. The two oil shocks of the 1970s made matters worse, especially when the government responded with reflation rather than retrenchment. Soon the rest of the world was talking of the Dutch disease, of “welfare without work”. The budget deficit touched over 7% of GDP in 1982.

Then came a big and, at first, largely unheralded change of direction. In 1982 representatives of business and trade unions (the unions' leader at the time being the durable Mr Kok) signed an accord in a suburb of The Hague called Wassenaar. Under this accord, later endorsed by the government, the unions promised to deliver pay restraint, including more decentralised wage bargaining, in exchange for a new emphasis on jobs. For its part, the government undertook to sort out its fiscal mess and to lower taxes. The Wassenaar accord laid the foundations for the economic renaissance of the late 1980s and 1990s,

when the talk turned from Dutch disease to Dutch miracle.

Advocates of the Dutch way like to claim that this miracle was a direct consequence of the polder model. The more fervent even urge the rest of Europe (and maybe the world) to learn from it and to adopt a similar model themselves. This survey will try to assess whether they are right to be so enthusiastic. Yet from the outset it is worth noting three objections to their claims—quite apart from the obvious difficulty of transplanting any model that is designed to suit one particular small country and its culture.

The first is whether there has really been a miracle at all: still a matter of some controversy, especially over employment. The second is whether, if there has indeed been a miracle, it had any particular connection to the polder model. These two points will be considered in the next article. Before then, though, a third objection should be answered: that the exact definition of the model remains unclear.

So what exactly is the polder model? Some say it means no more than a strong desire for consensus. But the more rigorous answer includes the institutional arrangements that long predate the Wassenaar agreement. Immediately after the war, the private Labour Foundation, which consists of representatives of both employers and employees (the “social partners”), was established; five years later, in 1950, the government set up the public Social and Economic Council, or SER, which has government representatives on it as well. Two ex-officio members of the council are the governor of the Dutch central bank and the director of the CPB, a semi-autonomous office for economic policy analysis that also prepares official forecasts.

The SER is supposedly nothing more than an advisory body. Even so, as Hermann Wijffels, its chairman, puts it, if its members agree on a policy, for example on social security or health-care reform, it is not easy for the government to ignore it. More generally, the SER mechanism encourages wide consultation between employers and unions, and not only over wages. This is made much easier by the country's small size, and by its traditionally sensible trade unions. Lodewijk de Waal, head of the unions' federation, talks openly of the need for higher profits and more labour-market flexibility, for example (though he also says he was against the Wassenaar accord at the time). Mr de Waal is in close touch with his counterpart at the employers' federation, Jacques Schraven.

But there is also a second, less widely noted component of the polder model: the Dutch political system. The Dutch republic was itself based on consensus, among the seven provinces that initially made up the United Provinces. Although the main province, Holland, was overwhelmingly dominant, big decisions required the approval of all: the 1648 treaty that finally ended the war with Spain was almost blocked by Zeeland, for instance. Thus consensus and decentralisation are built into the fabric of Dutch government.

Today's parliament reflects this. Proportional representation, the lack of any threshold before a party can gain parliamentary seats and the roots of most political parties in the religious “pillars” of Dutch society mean that there are many parties in parliament. All governments therefore have to be coalitions. Mr Kok's government was a left-right “purple” coalition of his own Labour party with the right-wing Liberal party and the small, left-wing D66 party. In one sense, this coalition can be seen as symbolic of the consensus-building that underlies the polder model. Such a broad coalition is more likely to adopt compromise policies.

Evaluation time

This is a particularly opportune moment to re-examine the apparent success of the polder model, for three reasons. The first is that, after nearly two decades of healthy performance, the economy has suddenly begun to look a lot less bouncy. Growth has slowed sharply, inflation has reappeared and unemployment is rising. Some critics have suggested that the economic wheels have come off the polder model. The more sober OECD, in its latest country report, notes merely that “these are undoubtedly testing times for the Netherlands, with the economy moving away from sustained non-inflationary growth.”

The second reason is that the normally predictable Dutch politics is under attack. The upheaval does not stem from the government's resignation on April 15th, which made little real difference, since an election was anyway scheduled for May 15th, after which Mr Kok had promised to step down. But it had long been assumed that the next government would be just another variation on the familiar theme, perhaps this time including the Christian Democrats. However, a new actor has burst on to the stage in the shape of the populist Pim Fortuyn. Mr Fortuyn is leading his own party into the election and may, say the polls, win so many seats that it will be hard to keep him out of the government.

Mr Fortuyn's arrival may be more than a coincidence. For the third reason for reappraising the polder model is that he reflects a growing dissatisfaction with the whole system. Despite their economy's success, Dutch voters, like those in France who recently backed Jean-Marie Le Pen, seem strangely disgruntled. Many are unhappy over their country's reputation for excessive tolerance—whether of immigrants, soft drugs, prostitutes or even gays (paradoxically, Mr Fortuyn is openly gay himself). There are particular worries over a practice known as *gedogen*, an untranslatable term that signifies acceptance of mild law-breaking: in effect, the opposite of New York's policy of zero tolerance.

The malaise that is showing in support for Mr Fortuyn is also strengthening the criticisms that some leading Dutch figures have been making of the cosy and consensual polder model itself. In recent months, both the governor of the central bank, Nout Wellink, and the finance minister, Gerrit Zalm, have suggested that the polder model may be past its best. Why do they feel this? A big part of the answer is to be found in their country's recent economic performance, which has not been quite as good as enthusiasts like to maintain. Nor, on closer examination, does it owe all that much to the polder model.

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Economic illusions

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The country's record on growth and employment is good, but not quite as good as it looks

THE figures certainly look excellent. In the two decades since 1982, Dutch GDP has grown by an annual average of 3.0%, faster than the European Union as a whole, and almost as fast as the United States. Measured by GDP per head, the Netherlands' ranking has improved from tenth among the EU 15 in 1991 to fifth today. Unemployment has fallen sharply, from a peak of 11% in 1983 to less than 2% this year, the lowest in the OECD—though there are, as we shall see, disputes about the true figure. And the government's fiscal position is enviable: last year it ran a surplus equivalent to 1.1% of GDP, and the public debt is now down to 51% of GDP, compared with a peak of 76% in 1988.

There are, however, several blemishes in this otherwise sparkling picture. The first is that, over the past year or so, economic performance has deteriorated sharply (see chart 1). After expanding at an annual average rate of almost 4% over the four years 1997-2000, GDP grew by only 1.4% in 2001 and is expected to do little better this year. Unemployment has begun to rise again, and the government's fiscal position to deteriorate. Worse, there has been an upsurge in inflation. Thanks partly to last year's tax reforms, which shifted the burden towards indirect taxes, consumer-price inflation hit a peak of nearly 5% last autumn, the highest in the OECD.

A big part of the explanation for the Dutch slowdown is the global economy. The Netherlands is one of the most open, trade-oriented countries in the world; when the world economy slows, as it did in early 2001, so does the Dutch economy. It is particularly exposed to its giant neighbour, Germany, whose economy has also slowed sharply in the past year. And it is also unusually exposed to the United States; not only does it trade extensively with America, but the two countries also invest heavily in each other.

But there were also home-grown reasons for the economic deterioration. The Netherlands' tax reforms, which cut top marginal income-tax rates to 52%, from a peak of 72%, may have been desirable, and even long overdue; but their timing, when the economy was already close to full capacity and prices were starting to rise, was unfortunate. All the evidence suggests that by early 2001 the economy was overheating: output was running above its sustainable trend and unemployment had fallen well below the non-accelerating inflation (or NAIRU) level, so some pick-up in inflation was inevitable.

What made it worse was that higher prices, low unemployment and labour shortages had begun to feed into higher wages, despite the country's famously sensible trade unions. The country has also experienced its own asset-price bubble: Dutch house prices are at record levels in relation to incomes. Even in the polder model, it seems, market forces cannot always be tamed.

Yet these are essentially cyclical problems; especially since September 11th, inflation has fallen back and unemployment has begun to rise. If the Dutch economy was overheating last year, it is now rapidly cooling off. But that will serve only to expose a more awkward structural fault: the country's relatively poor productivity performance. Improving that is now the country's biggest economic challenge.

Compared with this, indeed, the past few years' tasks of getting unemployment down and raising the country's low labour-force participation were in many ways the easy part. The Dutch were also helped by two macroeconomic forces, neither of which had much to do with the polder model: a highly competitive exchange rate in the run-up to Europe's monetary union, and a tight fiscal policy.

Competitive boost

Since at least the mid-1980s, the Dutch guilder has been rigidly linked to the German mark—so much so that Wim Duisenberg, then governor of the Dutch central bank and now president of the European Central Bank, was widely known as “Mr Fifteen Minutes”—the time said to elapse before he followed the Bundesbank's interest-rate changes. But the link conferred another benefit on the Dutch economy: because wage restraint kept down the rise in unit labour costs, the country's real exchange rate declined steadily, especially against Germany.

By the time the euro arrived at the end of 1998, there was a case for a revaluation of the guilder. But the politics were against it. Ireland was small enough and sufficiently far out of line to secure a small revaluation, but had the Dutch sought to follow suit so might the Belgians, and then the French would have grumbled. It was easier to leave things as they were. Besides, going into monetary union with an undervalued currency has helped to boost Dutch growth (just as doing the opposite has dented Germany's growth). On the minus side, that undervaluation was partly responsible for the overheating and relatively high inflation of the past year—exacerbated by the euro's depreciation against the dollar.

The other macroeconomic boon, fiscal restraint, was first promised by the government at Wassenaar. Before then, the Netherlands had been notorious for fiscal profligacy, especially when Mr Duisenberg was finance minister in the mid-1970s, before he became a more orthodox central banker. Yet it was not until the late 1980s, when Wim Kok became finance minister, that fiscal tightening really gripped. When Mr Kok took over as prime minister in 1994, his finance minister, Mr Zalm, continued to practise fiscal rigour through the “Zalm norm”, under which the fruits of growth are not spent but divided between debt reduction and tax cuts.

These two beneficial forces have now largely run their course. Recent wage inflation has eroded the Netherlands' competitive advantage over Germany and other OECD countries (see chart 2). Business profitability has fallen sharply in recent years. Fiscal restraint may prove harder to sustain in future, given rising demands on public services. Moreover, most of the gains to be had from increasing the labour supply have now been exhausted. If the economy is to return to the heady growth of the 1990s, productivity growth will have to be raised. And implementing microeconomic reforms such as increasing competition and improving the use of information technology to boost productivity is likely to prove hard—despite (or sometimes because of) the polder model.

None of this is to gainsay the transformation of the Dutch employment scene over the past two decades. Twenty years ago, the country seemed to be condemned, like much of the rest of Europe, to high youth and long-term unemployment, excessive welfare rolls and low participation rates among women and the old. In 1982 the employment rate (people in work as a proportion of the total working-age population) was hovering at only 52%. Today it is nearly 74%, which puts it just ahead of the United States (see chart 3). This is the largest increase seen in any OECD country, including America, over that period.

Once again, however, the picture is not as perfect as it appears. Although employment has risen sharply, hours worked have not; on average, the Dutch work the fewest hours in the OECD. Many jobs created over the past two decades have been part-time, often filled by women entering the workforce for the first time. Part-time work accounts for a third of total employment, twice the average for the OECD and the EU (see chart 4). Many other jobs have been temporary, or subsidised by the government. All this would be fine if people were freely choosing to work part-time, temporarily or for fewer hours. But that is not always true. Often, employers are avoiding rigid regulations and high minimum wages for full-time workers by taking on more part-time and temporary workers, who get less protection.

Participation rates also vary markedly by age group. Thanks partly to its successful labour-market policies, the Netherlands has done notably well in youth employment: it boasts the highest participation rate for 15-24-year-olds in the OECD. But it is a different story for 55-64-year-olds, where the participation rate is lower than in Germany despite that country's much higher unemployment. Early retirement is still far too prevalent for a country that, like most others in Europe, will soon have to cope with a rapidly ageing population.

Sick as a parrot

The low participation rate for older people is related to the biggest blemish of all on the Dutch employment record: its absurdly generous disability scheme, known as the WAO. Nearly a million people qualify for this, out of a total working-age population of around 7m, and the number is still rising. Taken at face value, that 15% rate would suggest that disability in the Netherlands is half as prevalent again as it is in comparable countries—even though, on most health criteria, the Dutch come out near the top of the rankings.

It seems more likely that the Dutch are not a particularly sickly people but that they have responded, as people do, to the incentives built into the system. Disability benefits have been generous, and qualification for the scheme has been lightly policed. In the 1980s it often sufficed to plead a bad back. Employers connived in WAO abuses, because the scheme became an easy and cheap way of getting rid of surplus workers. This is the darker side of the polder model: the two “social partners” jointly exploited the welfare system, at the expense of taxpayers and the wider economy. In effect, the WAO has been used to mop up disguised unemployment.

In 1997, a report by McKinsey, a consultancy, estimated that without this safety valve the true level of Dutch unemployment at that time would have been 20% rather than 8%. McKinsey reckons that the gap between recorded and true unemployment may still be not far off 12 percentage points. That rather takes the shine off the country's recorded unemployment rate of under 2%, though it does not negate its impressively high employment rate.

The problem of Dutch disability is not new, nor would it be fair to say that there have been no efforts at reform. The government brought in big changes in the early 1990s, when Ruud Lubbers was prime minister. Qualification criteria were tightened and benefit levels cut from, typically, 80% of previous salary to 70%. More of the cost burden was also shifted from taxpayers to employers. These measures, conceived outside the polder-model consensus, were deeply unpopular. The Hague saw its biggest demonstrations ever. In the 1994 election, both Mr Lubbers's Christian Democrats and Mr Kok's Labour party lost heaps of seats—but the Christian Democrats lost more, so Mr Kok still ended up running his purple coalition.

For all their unpopularity, though, the reforms had only a limited effect. It is harder now to qualify for disability by pleading a bad back: wags cite this as one of the few structural reforms ever made to the Dutch people. But although the number of new entrants to the scheme fell at first in the early 1990s, it

then rose again, thanks to a new wave of disability claims made on grounds of psychological problems and stress. The main failing is that benefit levels are still too high. Thanks to extra-statutory supplements, they can often be as much as 100% of previous pay during the first year of sick leave, the most generous anywhere in the world. And policing of the scheme is still too lax.

The government concedes that further reform to the WAO is needed. Last year it appointed a commission chaired by Professor J.P.H. Donner to come up with new proposals. The Donner commission suggested one radical change: to restrict new claims to people who are permanently disabled. But it did not propose to remove anybody who was already in the WAO; nor did it find an easy way to distinguish between temporary and permanent disability. In true polder-model style, the report was referred to the SER, but the plans that are now in the works look unlikely to be radical enough. The odds are that the new government will have to take much tougher action, probably without consensus. The disability scheme is a blot not just on Dutch employment but on the whole polder model.

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A fine place to be

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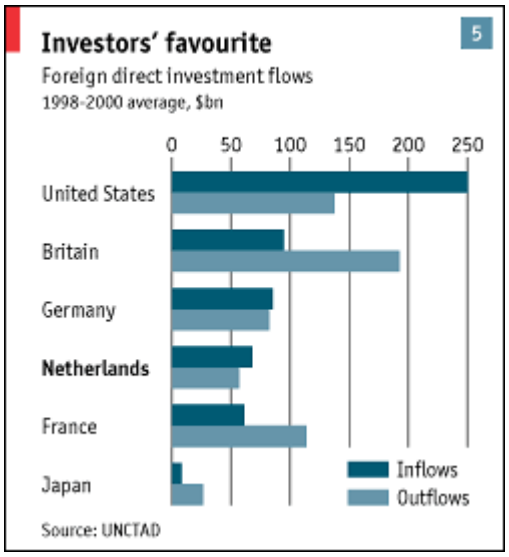
Dutch business is outward-looking and open to new ideas. But further liberalisation would help

EXACTLY 400 years ago, in the middle of the struggle against Spain, a group of Amsterdam merchants came together to create something entirely new: the Verenigde Oostindische Compagnie, the United East India Company. Although it was chartered as a monopoly by the States General of the United Provinces, it was a private shareholder company that paid dividends (which rose as high as 40% a year in its mid-17th century heyday). The VOC was, in effect, the world's first multinational; and although it was wound up in 1795, its legacy lingers in two respects.

The first is that the Dutch are still great merchants, traders and foreign investors. Rotterdam remains the world's biggest port, measured by the tonnage of goods moving through it. The Dutch are disproportionately large foreign investors; in global terms they rank in the top five (see chart 5). They are also great travellers: wherever you go in the world, you will soon meet a Dutch national.



The second legacy from the VOC era is the large number of Dutch-based multinational companies. For a country of only 16m people (albeit with the world's 14th-biggest economy), the roll-call is impressive. In electronics, there is Philips. In banking, there are ABN Amro, ING Group and Rabobank, all three ranked among the top 30 banks in the world. In retailing, Royal Ahold is a world leader. The insurance sector boasts one of the world's five biggest insurers, Aegon. And there are the Anglo-Dutch giants: Royal Dutch/Shell, the world's third-biggest oil company, Unilever, its biggest consumer-goods company, Reed-Elsevier, one of the biggest publishing groups, and Corus, Europe's second-biggest steel maker.

Even so, the heart of the Dutch economy lies in smaller businesses in such industries as food-processing, petrochemicals, engineering and software. Agriculture remains surprisingly strong for such a small country: the Dutch are big exporters of beef, pigmeat, chickens and dairy products. Horticulture is even bigger. Almost 370 years after tulip mania, the Dutch have the lion's share of the world's flower exports, and the countryside is littered with glasshouses. Laurens-Jan Brinkhorst, the agriculture minister, predicts that horticulture will soon account for half of all farm output. He has also presided over a sensible reorientation of farming towards markets rather than subsidies from Brussels.

Does all this make the Netherlands a good place to do business, despite its high taxes, over-regulated labour market, generous welfare state and habit of consensus-building? Most businessmen certainly seem to think so. In international surveys, the country consistently scores well. Last year, the Economist Intelligence Unit, a sister company of *The Economist*, ranked it as the best place in the world for investment. The Dutch have long offered corporate-tax breaks for international headquarters, to the annoyance of their Belgian and German neighbours.

Polder businessmen

What do businessmen think of the polder model? Most quite like it, and seem to find the labour market sufficiently flexible. Cees van der Hoeven, the boss of Ahold, says the polder model has pluses and minuses, but singles out the trade unions as the best in the world. He believes that the Dutch system

reconciles the need to share the pie out fairly but also to increase its size. He is not worried about claims that he pays too much attention to stakeholders and not enough to shareholders: his first priority is customers and his second employees ("associates"). If he looks after these, he believes, shareholders will benefit too. And he claims that there are often more, not fewer, regulations in America than in Europe.

Alexander Rinnoy Kan, a well-connected board member of ING, also praises the polder model. He says that by making complex decisions only after full debate, it ensures a stronger commitment to the results. Tony Burgmans, the Dutch chairman of Unilever, echoes this: he believes that red-blooded Anglo-American capitalism would not be popular with the consensus-minded, egalitarian Dutch. Kees Storm, outgoing boss of Aegon, concedes that "every now and then, a country needs a Thatcher." But, like most other bosses, he finds that Dutch people and the government are broadly pro-business.

The Dutch economy has never been all that strong in manufacturing; today services account for around two-thirds of GDP. Finance is especially important, as you might expect in a country that established the world's first central bank and first stock exchange. The Dutch banks have, for the most part, risen to the financial challenge. After several rounds of consolidation, the market is now dominated by the big three of ABN Amro, ING and Rabobank.

Rabobank is a peculiar but highly successful bank based in Utrecht. It is a co-operative bank that is especially strong in loans to farmers and home mortgages, and it has the biggest branch network in the Netherlands. It is also the only privately owned bank in the world with a triple-A rating. Its chairman, Hans Smits, dismisses the idea that it is parochial. Some three-quarters of the bank's total business comes from abroad, he says, noting its strong position in asset management through a subsidiary, Robeco.

Mr Smits insists that labour laws in the Netherlands, unlike those in France and Germany, are sufficiently flexible to permit job cuts. The country's other two big banks, ABN Amro and ING, have also managed to downsize, and they, too, are strongly international. ABN Amro is the biggest foreign bank in America, where some 40% of its staff work, more than in the Netherlands itself. The bank's chairman, Rijkmann Groenink, says that the bank seriously considered moving its headquarters to Chicago, but decided to stay put in Amsterdam.

Where the Dutch banks have failed is in global investment banking. ING bought Britain's Barings, but then pulled back from most of its equities and merger business, keeping only the emerging-market side, in which ING was already strong. ABN Amro has just pulled out of equities in America; it is closing the operation that it earlier bought, ironically from ING. Mr Groenink observes ruefully that the American investment banks were simply too strong. However, he insists that ABN Amro can still be a full-service, global wholesale bank to its biggest customers.

Atlantic, not European

Dutch multinationals' ventures abroad have tended to be across the water—in Britain, the United States, Latin America and Asia—not in continental Europe. Despite the much-vaunted single market, they have often encountered regulatory and other obstacles to expansion within the EU. Mr Storm of Aegon, over half of whose life-insurance turnover is now in America, says that Germany is a "closed shop". The banks have also found it hard to expand within the EU, except in neighbouring Belgium. Ahold's Mr Van der Hoeven recognises that France and Germany are gaps in his global plans, but he is happy that 60% of his company's sales are in America.

There are cultural as well as economic reasons for this fondness for America. As Mr Zalm, the finance minister, puts it: "The Netherlands is the most Anglo-Saxon country in continental Europe." The Dutch founded New York, and were the first foreign power to recognise the new country's independence from Britain. The Netherlands is the only continental European country to have developed extensive private pension funds on Anglo-American lines. Unlike the French, the Dutch have never felt impelled to fight against America's culture, or its language; several companies, among them ABN Amro, Aegon, Ahold, Shell and Unilever, operate almost entirely in English.

So why not move closer still to American capitalism, by throwing out most of the polder model and relying more on free markets? In fact, such a shift is already under way. Frits Bolkestein, one-time leader of the Dutch Liberal party and now the European commissioner in charge of the single market, believes that the polder model is heading towards what he calls a mid-Atlantic position. That would combine the best of both worlds: incentives and market forces as in America, with welfare protection on the lines of

Europe's traditional social model.

There was a moment when the first Kok government, in 1994-98, seemed to be pursuing a liberalising agenda that was pointing in this direction. Mr Bolkestein was not part of that government, though his Liberal party was, and it supplied Mr Zalm as the coalition's finance minister. Another key member was Hans Wijers, from D66, who was economics minister until 1997.

Mr Wijers, like many of today's top Dutch businessmen and academics, was influenced by his education and by working for an American group. So was his top civil servant, Sweder van Wijnbergen, who had worked in the World Bank in Washington, DC. Together, these two set about freeing up the more sclerotic bits of the Dutch economy. Part of their plan was to open up old monopoly businesses such as telecoms, postal services and energy to competition. A new competition authority was set up to sweep away the old Dutch image as a “cartel paradise”; in its first four years, it has barred or unwound no fewer than 350 cartels. Shop hours were largely deregulated. Privatisation was put firmly on the agenda. Even the notoriously management-friendly Dutch takeover code was due to be reviewed.

But then the reform programme ran out of steam, and both Mr Wijers and Mr Van Wijnbergen left government. Both men now lament the missed opportunities of the past five years. The auction of Dutch 3G mobile-phone licences was disastrous: amid claims of collusion, it raised too little money, yet the one-time state operator, KPN, remains saddled with huge debts accumulated at auctions in other European countries. There has been less enthusiasm for a plan to auction radio licences.

The 1997 McKinsey report identified not only unemployment hidden by the disability scheme, but also several structural barriers to growth, including insufficient competition, over-regulation of the labour market, a poor climate for business start-ups, inadequate corporate governance, a lack of incentives to create jobs, and land-use restrictions. Research and development were also picked out as weak points. Five years on, far too little has been done about any of these issues.

That is not entirely for want of trying. Inspired by the McKinsey report, the economics ministry now conducts a commendable annual benchmarking exercise that compares the Netherlands with other countries. The latest report confirms that liberalisation still has some way to go, although there are bright spots besides higher employment. For instance, in the Randstad area, the urban agglomeration stretching from Rotterdam to Amsterdam, more than half of businesses with a turnover of over $50m were started in the past 15 years, which is close to the figure for Silicon Valley or Boston and twice as high as in the Paris or Düsseldorf regions.

The real problem, however, is political. In recent months, rail privatisation has been postponed and the Labour party has turned against the privatisation of Schiphol airport. As the purple coalition came to an end, it lost its enthusiasm for deregulation and privatisation. That is especially unfortunate because the election campaign is now concentrating on voters' concerns about the state of public services—which need a dose of competition more than extra cash.

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The rule of common sense

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From public services to social policies, the Dutch are consummate pragmatists

ASK Dutch voters about their most pressing concerns and, besides the inevitable answers of immigration and crime, they are sure to mention public services. Educational standards are not what they were, businessmen grumble. The traffic jams are getting worse. Rail services are deteriorating. And perhaps above all, the country's health-care system is collapsing and there are waiting lists for medical appointments and operations.

The Dutch are famous for complaining. But to an outside visitor, especially one from Britain or America, this catalogue of woes seems astonishing. Schools in the Netherlands look modern and well-run, and the exam results are generally impressive. The traffic is bad, but it is not like London or Los Angeles. Besides, the Netherlands is a small, densely populated country with only limited space for more roads. Trains seem to be well run and reliably on time. As for health care, Dutch hospitals are mostly new and, although there are waiting lists, they are not nearly as long as in Britain or even Sweden.

Even so, complaints about public services have reverberated into Dutch politics. Every political leader talks of the importance of reorganising and improving public services. Economists fret about the tendency for productivity to lag in the public sector, even though wages must keep pace with the private sector. Ad Melkert, the Labour party leader, has laid out an agenda for spending more on education, health and other public services, and wants to relax Mr Zalm's policy of fiscal restraint that has made this harder in the past eight years. Yet Mr Melkert, like Mr Kok, talks also of the importance of reorganising public services.

In fact, the organisation of, and investment in, public services in the Netherlands are among the country's stronger points. In the spirit of their pragmatic traditions, the Dutch have understood and accepted two things that many other Europeans find doctrinally objectionable. One is that it does not matter who delivers public services, so long as the job is well done; the other is that competition, in some form, can help to make that more likely.

For historical reasons, as many as 70% of schools are privately owned, often nominally religion-based, even though they are publicly financed. Partly as a result, Dutch parents find it much easier than their counterparts in most other countries to choose their schools. Management is, in effect, devolved to school heads. This combination of choice and limited competition is entirely consistent with Dutch egalitarianism: there is no equivalent of such British independent schools as Eton.

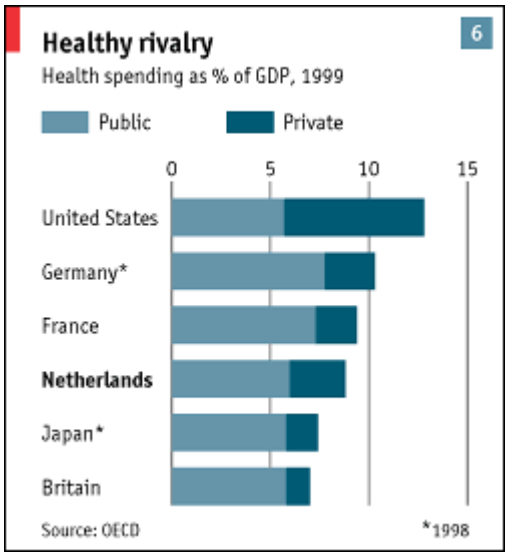
There should be more scope for using the market in other public services, but the politicians are dithering. The Dutch have invested huge sums in their transport infrastructure in the past, but they are being slow to build new high-speed rail lines. There has been much talk of road-pricing to cut congestion, but so far little action. The railways have been transferred to an independent company but, mindful of Britain's rail troubles, the government has backed away from full-scale privatisation.

Healthy competition

But the model that merits most attention from abroad is, paradoxically, the one that seems to be causing the most dissatisfaction at home: health care. The Dutch health-care system is based on the Bismarckian model of universal coverage through compulsory social insurance. But, unusually for Europe, almost three-quarters of Dutch hospitals are private, not-for-profit establishments, and almost all general practitioners are also independent. Even more unusually, the insurance system is also mixed. Two-thirds of the population are compulsorily enrolled in one of the country's health-care funds, but the remaining third, those on higher incomes, are insured privately. The whole population is also covered by insurance for long-term care.

Since the late 1980s, the Netherlands has been at the forefront of international efforts to introduce “managed competition” into health care. Patients are able to switch between insurers or health-care funds once a year, and insurers are not allowed to protect themselves from bad risks by turning anybody down. The insurers are encouraged to contract with doctors and hospitals of their choice. The idea is that there should be enough competition, between both insurers and service providers, gradually to turn the entire health-care system from being supply-driven and subject to central cost control into one that is demand-led and driven by patient choice—but still able to offer universal coverage at relatively low prices.

So why have the results seemed unsatisfactory? One answer is that Dutch consumers may be too demanding. The Netherlands has achieved enviable results in terms of quality of care and health outcomes even though it spends proportionately less than several other OECD countries (see chart 6). Nevertheless, it is also true that tight cost control by the finance ministry, combined with a limited supply of doctors, has contributed to both waiting lists and unsatisfied demand. Spending on health care as a share of GDP has fallen slightly in recent years, and it is probably too low.



Yet the real problem is not that the Dutch have moved too fast towards greater competition in health care, but that they have not moved fast enough. The original Dekker commission blueprint of 1987 has been implemented only in part. In particular, central regulation and cost control have been retained and even increased, rather than following the Dekker philosophy of greater reliance on market forces. Plans to abolish the distinction between health-care funds and private insurers, allowing everybody to make their own choice among all insurers, should improve matters.

Indeed, this next stage of reform, which will also relax central control and fully unleash the competition authorities on hospitals and doctors alike, will be critical. One point of controversy is that the Labour party wants the premiums paid to health insurers to be income-related, to help the poor. But that would negate an essential component of competition, on price. It would be better to help the poor through the tax system than by interfering in the health market.

If the Dutch reforms are pursued with enough vigour, says Professor Wynand van der Ven of Erasmus University, Rotterdam, the Netherlands might get closer than any other OECD country has to solving the world's big health-care conundrum: how to improve service delivery and provide universal coverage,while using the market rather than the government to hold down total health-care spending.

The area of social policy for which the Netherlands is most famous, however, does not involve the public services at all. It is how the country has tackled such problems as drug abuse, prostitution, abortion and euthanasia. Here, too, other countries have much to learn—if only they can overcome their widespread misunderstanding of Dutch policies.

Reuters

Just another union member

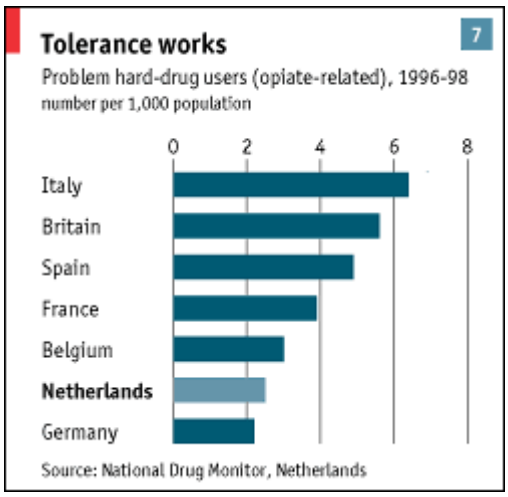
Consider drugs. Foreigners visiting one of Amsterdam's 228 “coffee shops”, which offer a menu of

different kinds and strengths of hashish with all the flourish of a sommelier producing his wine list, assume that the Dutch have legalised soft drugs. Yet it is not so. The growth and sale of all drugs, including cannabis, remain illegal. But in the past 25 years the Dutch have brought in two reforms. The first is to treat drugs as a health, not a criminal-justice matter. Consistent with this, consumption of drugs is not illegal.

Second, and more controversially, the Dutch authorities have applied what they call the "expediency principle". This means that public prosecutors are advised not to take action against coffee shops selling cannabis, subject to certain restrictions. These include a maximum sale of five grams per person, no sale of hard drugs, no advertising, no sales to minors and no nuisance to neighbours. In addition, the stock held by any one coffee shop must not exceed 500 grams. The buying of cannabis by coffee-shop owners remains illegal, but is tolerated in accordance with the practice of *gedogen*. The idea is to separate and regulate the sale and use of soft drugs, to keep mild drug abusers out of the criminal-justice system and thus to minimise the risk that cannabis might become a gateway to harder drugs such as heroin.

Over the years many other countries, notably America, Britain, France and Sweden, have condemned this Dutch regime wholesale. Yet by its own lights it has been remarkably successful. Cannabis use has admittedly risen a little, but surveys show that it is still less widespread in the Netherlands than it is in Britain and America, and about the same as in France and Germany. Among schoolchildren, cannabis use in the Netherlands has actually been going down over the past few years. And the regime has been tightened up: the amount that each person was allowed to buy was reduced from 30 grams to the current five grams five years ago, and the number of coffee shops cut back, especially in border regions where they were encouraging drug tourism.

As for hard drugs, notably heroin and cocaine, the evidence supports the Dutch approach of looking on their use as health problems. Treatment is available through methadone and even medical prescription of heroin, together with clean needles. Yet heroin abuse is now much less prevalent in the Netherlands than it is in Britain and most other European countries (see chart 7). Indeed, the population of hard-drug addicts as a whole has barely grown in the past ten years, and it is ageing fast, suggesting that younger people are not joining in. The lesson is clear: partial decriminalisation, and treating drugs in general as a health rather than a justice problem, seems to work.



Horizontal integration

Dutch tolerance extends to sex. Prostitution is legal, and in 2000 brothels also became legal for the first time since 1912. The intention of the new law is to turn "sex work" into just another job, complete with employment rights and even a trade union. There is no evidence that prostitution has increased as a result: indeed the famous red-light district in Amsterdam is, if anything, smaller than it once was.

Most prostitutes seem to dislike their new legal status, because it has forced them to pay taxes, and it has made it easier for the police to drive illegal immigrants out of the business. The legalisation of brothels has also encouraged sex tourism, which is good business but not always pleasant when the visitors are drunk and rowdy. Amsterdam prostitutes say they quickly felt the effects when easyJet introduced cheap flights from Britain. But they also admit that the Netherlands has done more than most to separate organised crime from sex work.

Gay rights, too, have advanced further than in other countries. After a long campaign, marriage between gays became legal last year in the Netherlands, for the first time anywhere. Henk Krol, editor of *Gay Krant*, who led the campaign, is careful to insist that this is not "gay marriage". It is, rather, the application of the normal civil marriage code to gay couples. It is hard to imagine any other country in which the sexual orientation of such a controversial figure as Mr Fortuyn would be so little discussed by the press.

And then there are abortion and euthanasia. The Netherlands was one of the first countries in the world to legalise abortion in the 1960s. Yet at the same time it has sought to discourage the practice, not least

through sex education for minors. For some years now, it has boasted the lowest abortion rate in the world.

In euthanasia, too, the Dutch have been pioneers. Their policy started, as usual, with the simple recognition that assisted suicide was taking place. Rather than ignore it, policymakers devised a way of regulating it instead. Under the new act, which came into full force only this year, doctors who assist a suicide are exempt from prosecution provided they can satisfy the authorities that they have followed a strict code of conduct. This includes a requirement to consult a second doctor, and to offer and discuss alternatives of palliative care. Relatives have only a limited role, and “living wills” are generally recognised.

The result has not, as critics feared, been a mass outbreak of euthanasia. Controls are rigorous, and two-thirds of requests are refused. The health ministry estimates that euthanasia plays a part in about 2.4% of all deaths—not much more, probably, than it did before being legalised.

Pragmatism, not tolerance

There is a common thread to all of these policies; and it is not, as is often assumed, that the Dutch are unusually tolerant. They are respectful of others' privacy, certainly. But the dominant Calvinist religion of the Dutch reformed church has never been noted for tolerance. Although the country is now largely secular, there is still a powerful “bible belt” across the south and north-west. Outside Amsterdam, the Dutch are strongly family-oriented, and neither particularly tolerant nor especially liberal.

Indeed, many politicians and business leaders today bemoan a culture that they feel has come to put too much emphasis on rights and not enough on obligations. The practice of *gedogen* got an especially bad press after two huge accidents, including an explosion at a fireworks factory in Enschede in 2000 that killed 22 nearby residents, revealed wholesale flouting of health-and-safety rules.

What the country's social policies show is not that the Dutch are soft-pink libertarians, but that they are thoroughly pragmatic in their approach to social problems. In particular, experience has taught them that legalising and then regulating an undesirable practice is often the best way of controlling and even curbing it.

It is entirely consistent with the polder model that, on the whole, most of these Dutch social policies command a political consensus (although the Christian Democrats say that they want to reverse both the tolerance of coffee shops and the legalisation of euthanasia). But Dutch pragmatism and the polder model alike are about to undergo perhaps their stiffest examination, with the elections that are to take place on May 15th. The arrival of Pim Fortuyn on the political scene will test both to the limit.

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Political games

May 2nd 2002
From The Economist print edition

Why Dutch politics can never be simple

AP

Pim's number one

DUTCH politics used to be so reliably dull. The three main parties are, on the left, the Labour party (known by its Dutch initials as the PvdA); on the right, the Liberals (the VVD); and in the centre, the Christian Democrats (the CDA), which brought together several Christian parties. The smaller D66 is a leftish party founded in 1966, when Amsterdam was in the grip of the "provos". There are other small parties, notably the Greens. But Dutch coalitions have tended to be made up of the big three plus (or minus) D66.

The etiquette of the election game and of government-making has also long been formalised. After an election, the queen appoints a "formateur", who begins discussions with the leader of the biggest party, who in turn normally becomes prime minister. But the prospective prime minister has to construct a coalition, complete with a full programme. This part of the game can take several months—a period when, as civil servants in The Hague like to say, Dutch government is often at its best. Once the coalition is in place, it usually stays there until the next election, though it can be pulled down at any time if one of the partners walks out.

Until 1994, the Christian Democrats or their predecessors had been part of every coalition government in the 20th century; the party's leader, Jan Peter Balkenende, jokes that it was in office for longer than the Soviet Communist Party. But in 1994 the game entered a new phase: the centre was dropped and the two extremes came together, with D66 holding the ring. This "purple" coalition under Wim Kok proved remarkably successful, so it presented itself again to the voters in 1998. A slight wobble came in 1999, when D66 walked out, but the party was quickly lured back.

Last month, however, Mr Kok's government decided to resign after an officially commissioned report criticised the Dutch over the Srebrenica massacre in 1995. The resignation looks admirably principled. But in truth, the government's hand was forced: the Liberals were already thinking of walking out. And Mr Kok continues as interim prime minister.

Until late last year, it had been assumed that his successor would be either Ad Melkert, the new Labour party leader, or Hans Dijkstal, the Liberal leader, with the coalition of their two parties possibly continuing. Mr Balkenende, who took over his party only last October after a bitter internal fight, was waiting in the wings; everybody agreed that D66 was heading into opposition. But now the apple cart has been comprehensively upset by Pim Fortuyn, a charismatic, fashionably bald, gay former sociology professor and journalist.

Enter right, a Rotterdam rottweiler

Last year, Mr Fortuyn, once a Marxist-leaning intellectual, was made leader of a small leftish protest party called Leefbaar Nederland (*leefbaar* means liveable). He promptly took the party to the right, lambasting the government for allowing uncontrolled immigration, and attacking Islam (especially after an imam in Rotterdam said that gays were worse than pigs). He also proclaimed that the trouble with public services was excessive bureaucracy: he thinks a quarter of civil servants should be booted out. Above all, Mr Fortuyn assaulted the cosy consensus that has governed Dutch politics for so long.

Mr Fortuyn was soon kicked out of his party, for suggesting that Article 1 of the constitution, which bans any kind of discrimination, should be changed. But he then started his own party, List Fortuyn, which did

astonishingly well in the local elections in March. In Rotterdam, Mr Fortuyn's power-base, it took 17 out of 45 council seats. The opinion polls suggest that it will also do well, if less spectacularly, in the national elections on May 15th. There is even a chance that List Fortuyn could come out ahead of the Liberals.

How was Mr Fortuyn able to break into the political game? The question makes established parties uncomfortable. He does not have a full range of clear policies: a book he published in March is notably vague, except for its anti-immigration insistence that “the Netherlands is full.” Frits Bolkestein, the former Liberal leader who is now a European commissioner, blames the purple coalition for ignoring the immigration problem, which he thinks should have been tackled a decade ago. In that sense, Mr Bolkestein argues, it was Wim (ie, Mr Kok) who begat Pim.

Mr Kok dismisses this as a cheap political jibe, and suggests that instead of running away to Brussels, Mr Bolkestein should have stayed at home to fight people such as Mr Fortuyn. Indeed, Mr Kok and his party think it was Mr Bolkestein's launch of the immigration debate that paved the way for Mr Fortuyn: Frits begat Pim. Mr Kok notes, too, that September 11th hugely aggravated the problem, making it easier to stir up anti-Islamic feelings.

Beyond this point-scoring, two broader conclusions can be drawn about Mr Fortuyn's rise. The first concerns immigration. The Dutch republic was long welcoming to outsiders, from Huguenots to Jews, and today's Netherlands still prides itself on this. Especially since the second world war, when nearly four-fifths of Dutch Jews were sent to the gas chambers (a higher proportion than in Belgium or France), the Dutch have been highly sensitive to anything that smacks of picking on ethnic minorities. Dutch newspapers were for many years reluctant even to report that a criminal was black, for instance.

Yet behind such political correctness, the Netherlands has never come to terms either with being an immigrant country or with multiculturalism. The numbers are startling: already ethnic minorities make up almost 10% of the population, a higher share than in Britain or France. In Amsterdam and Rotterdam, the figure is over one-third. Mr Bolkestein observes that, within 15-20 years, half the population of the four big cities will be from ethnic minorities; over half the prison population is already.

What should the politicians do? Not much, most say. Mr Kok claims that tightening up the rules, especially on asylum, has already cut the numbers of new arrivals by 25%. Mr Melkert points out that, unless the Netherlands abrogates international treaties on asylum, there is little that even Mr Fortuyn could do to make immigration controls tougher. Yet the political leaders still pander to the sentiment stirred up by Mr Fortuyn, for instance by insisting on integration (including learning the Dutch language) rather than accepting or even celebrating multiculturalism. In fact Amsterdam is multicultural already—this is one of its great assets. And as its population ages, the Netherlands is going to need more, not fewer, immigrants.

This debate is now becoming sadly familiar in many European countries—witness Mr Le Pen's recent success in France—which points to the second general conclusion about Mr Fortuyn. It would be wrong to assume that he is just another right-wing politician like Mr Le Pen, Austria's Jörg Haider or the leaders of Belgium's Vlaamse Blok. He himself strenuously denies this, claiming rather an affinity with Italy's Silvio Berlusconi, the British Tory party (he is a great admirer of Margaret Thatcher) and Bavaria's Edmund Stoiber. Yet he appeals to voters who feel that their concerns over immigration and crime have been ignored by the established parties. In any system with proportional representation, that appeal can translate quickly into a political force.

The never-had-it-so-good factor

The real question is why these voters are so disillusioned, after a decade of such solid economic progress. Some politicians suggest that their very prosperity is part of the problem. The tough economic policies needed to pull the Netherlands out of its mess in the early 1980s have been forgotten; voters are now affluent enough to concentrate not on jobs but on public services and crime. Mr Melkert and Mr Dijkstal like to think that Mr Fortuyn may have peaked in the local elections: when it comes to the more serious business of a national election, protest votes usually fall away, and Mr Fortuyn's poll numbers have indeed slipped a little.

Even so it would be wrong for the politicians to dismiss Mr Fortuyn's support as merely a temporary by-product of success, to be answered by spending more on public services. There is considerable dissatisfaction with all the established parties, which seem altogether too cosy. Thanks to years of coalition carve-ups, there is little ideological fervour about any of them. In some ways, the parties are

now mere patronage machines: they no longer offer ideas or policies, but just jobs for the boys.

This tendency is made worse by the professionalisation of politics, which tends to produce well-meaning but colourless leaders. Dutch parliamentary debates are dull in the extreme. Mr Melkert is a splendid example of a man entirely at home discussing the finer points of social-security policy. Mr Dijkstal may be a cheerful saxophone player, but he lacks the charisma of his predecessor, Mr Bolkestein. Mr Balkenende has the advantage of a party that has been out of office; but, for all his protestations that the Christian Democrats have used the past eight years to develop new policies for a “responsible society” and a new “moral agenda”, he offers few genuinely new ideas.

What of Mr Kok? Seated in the Binnenhof, in a small corner office, he seems just another mild and unassuming politician, yet despite his resignation over Srebrenica, he remains the nearest the country gets to an international statesman. He is closely linked to recent Dutch success, including at Wassenaar in 1982, when he was the union leader who accepted wage restraint, and he was finance minister in the 1989-94 Lubbers government. Indeed, some say he did more for the Netherlands in those five years than in eight years as prime minister.

Mr Kok's legacy may now be tarred by his resignation. Yet he is visionary enough to declare that he still sees a need for change in the Netherlands. He says that reforms can never end, and that the public services need reorganisation. Even so, he remains a firm believer in the polder model: shared responsibility for decisions, he says, is helpful, and need not mean shying away from radical change.

The upstart Mr Fortuyn firmly disagrees: he says that “we have to change from the polder model to a conflict model.” But for all his charm, charisma and gift for one-liners, Mr Fortuyn too is lacking in original ideas. He insists that he is no racist, but is voicing justifiable concerns about the backwardness of Islamic civilisation and culture. He wants to tear up the EU's Schengen treaty and re-erect Dutch border controls, but he is not seeking to throw out immigrants, even Islamic ones, already in the country. He merely says that “they must accept the country's standards and the values of modernity.”

Mr Fortuyn makes much of the claim that he is articulating what everybody has long wanted to say. His apparent assault on the constitution reflects what he calls 25 years of “complete dictatorship against the freedom of speech.” The reason for his success, he declares, is that people feel that they can at last say what they really think about a multicultural society.

Yet there is more to it than the emergence of long-suppressed feelings. Mr Kok and Mr Fortuyn fit the Dutch ideal of a classless, meritocratic society. But others in the elite do not. Class may be weaker than in other countries, and history has meant that the rich are merchants, not aristocrats. But many Dutch politicians, civil servants and business leaders have known each other for most of their lives; they belong to exclusive clubs or corps that often date from their university days, and do not welcome outsiders. In this sense, Mr Fortuyn represents a rebellion against a self-satisfied and introverted establishment, as much as an anti-immigrant platform. His party is a classic protest party.

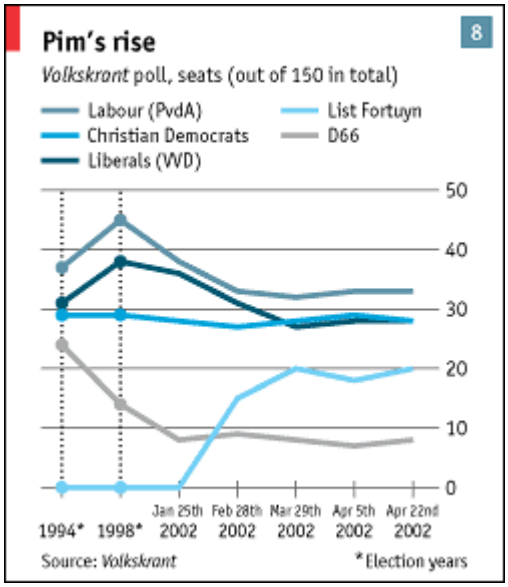
After the ides of May

That does not mean that it will wither away. Indeed, Mr Fortuyn believes that he will be the next prime minister. Last year it seemed more likely that the Liberals would be the biggest party, and that Mr Dijkstal might become their first-ever prime minister. But Mr Fortuyn's party has eaten into the Liberal vote. That may make Mr Melkert's Labour the biggest party yet again, although the Christian Democrats could pip it to the post (see chart 8).

Whatever happens, Mr Fortuyn will greatly complicate the business of forming a coalition. Mr Melkert says that Mr Fortuyn is arguing for a “tough, heartless society where social legislation, the role of trade unions and the interests of minorities and of people on low incomes are put aside.” He rules out allowing Mr Fortuyn to take part in government, and criticises both Mr Dijkstal and Mr Balkenende for not making the same pledge. For his part, Mr Fortuyn welcomes Mr Melkert's refusal to join him in any government.

No two of the big three parties are likely to have enough seats to gain a majority. A possible solution would be for all three to join a

grand coalition. But Mr Bolkestein declares that this would be a "disaster", reminiscent of the *cordon sanitaire* thrown round the Vlaamse Blok in Antwerp; it would leave Mr Fortuyn as the only clear opposition, letting him garner more votes next time round. Better, in Mr Bolkestein's view, to put him in government: Leefbaar Nederland was similarly put in charge of Hilversum's council, but did the job so badly that it was thrown out in March.



In truth, nobody knows what might happen until after the election—and possibly for a long time after it. Any of the present leaders could become prime minister, though Mr Balkenende may be the most likely. So might somebody else altogether: a former Liberal leader who was deputy prime minister in the 1970s, Hans Wiegel, has said he is willing to serve.

This uncertainty highlights several unsatisfactory features of the present system. One is that voters do not really get to choose their next prime minister. Even if a party loses a lot of votes, as Labour did in 1994, its leader can still become prime minister; so can a leader of a party that does not command the biggest number of seats. Governments emerge from smoke-filled rooms as much as from the ballot box, partly thanks to rigid party lists that give the centre too much control and fail to provide a direct link between members of parliament and their constituents. To cap it all, despite the Netherlands' long federal tradition, local democracy is not strong enough: mayors are nominated by the central government, as are queen's commissioners for each province.

Some of this is under attack. D66 has long pushed for directly elected mayors, and has just managed to get one. It also wants more referendums. Setting thresholds for small parties and fashioning a constituency system would also help. But all this will take time. The present system has to deal with Mr Fortuyn. The rest of Europe looks on apprehensively.

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A place in the world

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Who would argue with the Dutch?

AP

Balkan mission impossible

THE Netherlands has long had a world role out of proportion to its size. At its zenith in the 17th century, the Dutch thrashed the English navy (Samuel Pepys's boss in 1667 complained that “the Devil shits Dutchmen”); in 1688, they staged what amounts to the only successful invasion of Britain since 1066. They also ruled the world's largest empire, from northern Brazil to the East Indies. Dutch colonial history has little more to commend it than any other: the Indonesians noisily boycotted the 400th-anniversary celebrations of the East India Company. But a tradition of world engagement lives on.

Consider two examples, one bad, the other good. The first is the Balkans. Dutch troops were in Bosnia from the start of the UN intervention. Fatefully, it was a detachment of Dutch peacekeepers that was sent to protect the “safe haven” of Srebrenica in 1993. Two years later came disaster: the surrounding Bosnian Serbs walked in, disarmed the Dutch, and then massacred over 7,000 Muslim men and boys.

The Dutch government commissioned an inquiry, which at long last reported in April. The inquiry concluded that the soldiers were sent on an “ill-conceived and virtually impossible mission.” Although the fault lay more with the UN, especially with the Americans, British and French, this was enough to prompt the Kok cabinet and the country's top general to resign. Although this gesture might be seen as an apology on behalf of the West as a whole, Srebrenica will remain a stain on the country's international image.

The second example is altogether more favourable: the increasing importance of the Netherlands in the world system of justice. The Hague boasts not just a world court to arbitrate on international disputes, but also the Balkan war-crimes tribunal, which is trying Slobodan Milosevic. It will also host the International Criminal Court. The rest of the world seems instinctively to trust the Dutch sense of justice and fair play.

Nowadays, however, the Netherlands' global engagement focuses chiefly on two institutions: NATO and the European Union. Recently its support for both has become a shade less unequivocal than it once was. In keeping with their Atlanticist instincts, the Dutch were long among the most fervent NATO supporters, willing, for example, to accept short-range nuclear missiles in the 1980s. Yet today they show little enthusiasm for raising their inadequate level of defence spending. More pointedly, the Netherlands dragged its feet over the invocation of NATO's Article 5 after September 11th. It is still suspicious of American military adventurism abroad.

Such fretting over America has not, however, translated into renewed enthusiasm for European integration. The Dutch are not particularly keen on more European defence co-operation, lest it clash too overtly with NATO. And, though they remain natural believers in closer European union and staunch supporters of the European Commission, and are proud that both the 1992 Maastricht and 1997 Amsterdam treaties were negotiated on their soil, their European policy has recently put far more emphasis on the pursuit of national interests. At the summit negotiating the Nice treaty in 1999, for instance, Mr Kok fought tenaciously to gain one more vote than Belgium in the EU's Council of Ministers, breaking parity between the two countries for the first time—and in the process severely straining bilateral relations.

Three things lie behind this new Dutch assertiveness in Europe. One is simply the example of other

countries. Despite the drive towards integration, symbolised this year by the arrival of euro notes and coins and the opening of a grand convention on the future of Europe, the European Union has seen a general seepage of power back to national capitals. Dick Benschop, the minister for Europe, voices the smaller member countries' ritual support for the commission and opposition to inter-governmentalism, but he also talks about networking among capitals and making progress by “benchmarking” rather than through more integration.

The second explanation is money. For years the Dutch, with their large farming industry and small but efficient farms, did well out of Brussels, but reforms to the common agricultural policy hit them hard. In recent years the Netherlands has become the second-biggest net contributor to the EU budget; on a per-head basis, it pays in more than anybody else, more even than Britain did in 1979-80, when Margaret Thatcher launched her campaign to get “my money back”. Mr Fortuyn declares that he wants “to borrow her handbag”. It is unlikely that the Dutch will ever push matters that far, but their new role as paymaster of Europe has certainly made them less keen on a bigger EU budget.

The third reason for the Netherlands' new assertiveness is Frits Bolkestein. It is ironic that he should now be the country's European commissioner in Brussels, for when he was Liberal leader he was the first mainstream Dutch politician to start questioning the EU's usefulness. Some claim that he was the country's first Eurosceptic. Mr Bolkestein denies the charge: he is an enthusiast for the commission, where he heads the single-market programme, and he finds Mr Benschop's networking ideas dangerously inter-governmentalist. But he also believes that European federalism was for far too long a form of religion in the Netherlands, with any doubters treated as heretics. He himself does not think that a European federation will, or indeed should, come into being, claiming that the Dutch more or less invented the nation-state in the 16th century.

Now that Mr Bolkestein has shown the way, more Dutch leaders are ready to criticise the EU. The Netherlands was the fiercest opponent of bending the Maastricht rules to let countries such as Italy that did not comply strictly with them join the euro. And although it is in favour of EU enlargement to the east, some politicians are questioning the speed at which it is happening. The Liberal party's Mr Dijkstal has expressed reservations about plans to admit new members by 2004.

A global role model

If they are no longer such model Europeans or Atlanticists, what example are the Dutch setting to the rest of the world now? The most popular answer is the polder model, with its supposed economic and social benefits. Yet, as this survey has argued, the country's recent economic success has had little to do with that model. Indeed, a persuasive case can be made that the polder model helped to create the economic disasters of the 1970s and early 1980s. It may not be well suited to the tougher deregulation and further liberalisation that the economy now needs; it may work best of all when it is not really needed. Mr Kok insists that “you can take radical decisions with the polder model.” But Mr Bolkestein is nearer the mark when he argues that “consensus is a beautiful thing, but good policy is better.”

This is not to say that the Dutch should jettison the polder model; nor that there is nothing in it that the rest of Europe should copy. It would be good for other countries' economies, for instance, if their trade unions were as moderate as their Dutch brethren. As the Dutch unions' leader, Mr de Waal, points out, it would be good for other countries' unions too: the Netherlands is one of very few rich countries in which trade-union membership is increasing. *Pace* Lady Thatcher, consensus is not always a bad thing, either. In an area as complex as health care, it is surely better to evolve slowly towards the Netherlands' managed competition than to lurch, as Britain often has, from one half-baked reform to another.

But the real lessons from the Netherlands lie elsewhere: and above all, in its pragmatic approach to solving social and economic problems. A welfare state that is too generous, and a labour market that is too rigid? Follow the Dutch example of chipping away at the first and quietly introducing flexibility into the second. Taxes that are too high and public spending that defies cutting? Look at the Dutch tax reforms that sharply lowered the burden of direct taxes, and at the finance ministry's tough spending controls. Too much drug abuse, or controversy over mercy-killing? Go Dutch again: partial decriminalisation of soft drugs and legalisation of euthanasia seem to do the trick. Troubles with transport and city-centre congestion? Visit such cities as Amsterdam and The Hague, where cars are kept at bay, parking is fiercely policed, bicycles are firmly encouraged and trams are efficient and cheap.

The fact is that the Netherlands has long served as a model to the rest of the world, to emulate or learn from. For its time, the Dutch republic was one of the most open, liberal and democratic governments in

the world. Dutch painters, from Vermeer and Hals to van Gogh and Mondriaan, are among the world's greatest masters: Simon Schama's splendid history of the Dutch golden age, “The Embarrassment of Riches”, is an iconography built around Dutch paintings and drawings. Dutch architecture, too, stands up well to comparison, from Amsterdam's neoclassical town hall (now the capital's royal palace) to the strikingly original modern buildings in Rotterdam or The Hague. Even Dutch sport bears imitation: the country invented “total” football, and for many years had one of the world's best teams.

Not any more, alas: the Netherlands failed to qualify for this year's World Cup. Indeed, for a country that has so much going for it, in sensible policymaking and a good lifestyle, it has a curiously spotty record, with plenty of under-achievement. That may be why the Dutch seem dissatisfied and unsure of themselves—and why so many have been seduced by the siren voice of Mr Fortuyn. It is time they cast aside this lack of confidence (and, with luck, Mr Fortuyn too). They have much still to teach—if only the world will learn.

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May 2nd 2002
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This survey draws on many sources and interviews, not all of them cited in the text. Among the most useful sources were the OECD's report on the Netherlands (February 2002); “Benchmarking the Netherlands” (Ministry of Economic Affairs, March 2002); “A Dutch Miracle” by Jelle Visser and Anton Hemerijck (Amsterdam University Press, 1997); “Holland” by Adam Hopkins (Faber and Faber, 1988) and “The Dutch Republic: its Rise, Greatness and Fall” by Jonathan Israel (Oxford University Press, 1995). The author would also like to thank the Dutch Ministry of Foreign Affairs and the British Embassy in The Hague.

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General Electric

The Jack and Jeff show loses its lustre

May 2nd 2002 | NEW YORK
From The Economist print edition

Reuters

Why the world's most valuable company is running into the sands

Get article background

WHAT is General Electric? A year ago, the answer seemed as straightforward as the company's peerless reputation. “The world's most admired company,” sang *Fortune* magazine. The company's “legendary” boss, Jack Welch, had some claim to being “the most successful manager of the past quarter-century”, according to no less an authority than *The Economist*. Yet many a fancy reputation among blue-chip companies has taken a tumble recently. Enron, Global Crossing and Andersen have turned to dust before investors' eyes, and several other once spotless names face sharp questions. And so, in a spirit of inquiry, the financial markets have begun to test the worth of GE, owner of the fanciest and most valuable corporate reputation of all. The markets' methods are simple and blunt: hit the company hard, and see what happens. Then hit it harder.

In August 2000 GE's shares were fetching $60 apiece. On April 24th, the man who succeeded Mr Welch last summer, Jeffrey Immelt, held his first shareholders' meeting. That morning, GE's shares had sagged below $33, valuing the company at $268 billion less than its worth at its peak. “GE is a company with an underperforming share price,” Mr Immelt confessed to his shareholders. “I hate where our stock price is today.” Not that he is taking all the flak. As GE's share price has taken a bashing, so has Mr Welch's reputation. Commentators who marvelled at his 20 years in charge now tut and shake their heads.

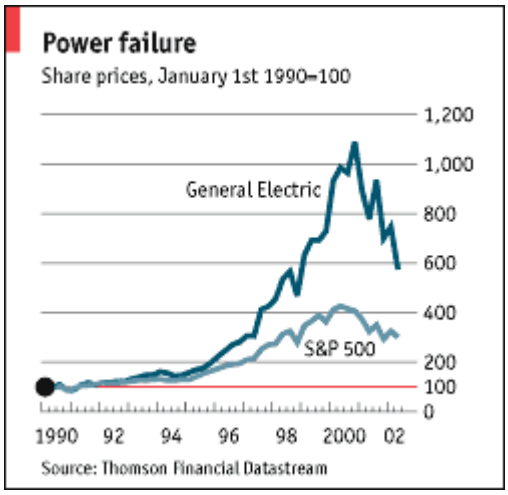
Suddenly, GE stands accused of all sorts of shenanigans. In March, one of the most prominent buyers of its $100 billion of commercial paper, Bill Gross of PIMCO, a fund-management group, accused the company of dishonesty and said he would cease to buy its short-term debt. The price of GE's $233 billion of debt promptly fell, pushing up the company's interest costs. GE's new interest costs reflect more accurately the true riskiness of the company, argues Mr Gross. GE's reputation rests on the superb management of its industrial businesses, from aircraft engines to light bulbs. But in truth, argues Mr Gross, GE is at bottom a financial company, open to the same set of risks as any other financial firm. What sets GE apart, he says, is that its risks are disguised.

GE's reported profits continue to grow at an impressive pace. But some analysts and investors worry that the company's profits growth is, in fact, slowing. GE also has a long-standing reputation for “managing” its earnings, by taking money from one pocket and putting it into another. Depending on your sympathies, GE does this either to help smooth reported earnings (and therefore to disguise all that hidden riskinesss), or to demonstrate more clearly to investors the growth of the company's underlying

businesses.

Add these worries together, and you get another: having become adept at one form of earnings management, GE may have succumbed to another, more malignant form, and is now covering up slowing growth by earning money in ways it says it is not. Because GE is so big and runs so many financial businesses, only a handful of its top people properly know the answer to that question. One thing is clear, however: GE is not exactly behaving like a company with nothing to hide.

According to the way it presents its accounts, GE is better explained not by one set of numbers, but two. First there are those famously well-managed industrial businesses: power and industrial systems, aircraft engines and so on. These businesses (call them “GE Industrial” rather than “GE”, as the company confusingly does) carry almost no debt, throw off wondrous amounts of cash and deserve the triple-A credit rating that such agencies as Moody's bestow on them.



The second, less well-known set of businesses are financial ones: commercial and consumer lending, leasing and insurance operations, collectively known as GE Capital. This unit has a good reputation among GE's stock analysts (who tend to be electrical-equipment experts), but not among bank analysts, who have seen too many financial firms come unstuck—especially ones built, like GE Capital, on acquisitions. Like all finance companies,GE Capital makes its money by borrowing large sums against much smaller amounts of shareholders' money. Unlike a commercial bank, which can rely on a stable base of bank depositors, GE Capital must borrow its money in the wholesale markets, which tend to be more capricious, as Mr Gross has proved recently. GE Capital is rated triple-A, too, but only because GE Industrial supports it—for instance, by underwriting some of its debts.

According to GE's accounts, shareholders have about two-thirds of their money invested in GE Industrial and one-third in GE Capital. It could be argued, however, that this accounting presentation misstates the true allocation of capital at GE, or understates the true riskiness of GE Capital. Without the support of GE Industrial, GE Capital would need more capital from its parent to hang on to its triple-A rating, says Moody's. This would shift a greater percentage of shareholders' money to riskier financial businesses—which is what the cross-support does now, but not explicitly. Or GE Capital could be run with less capital, a lower credit rating and higher interest costs. Either way, GE Capital's return on equity—currently a reported 22%—would look less good. The cross-subsidy, in other words, hardly aids transparency. GE argues that its financial businesses are no riskier than its industrial ones.

Industrial decline

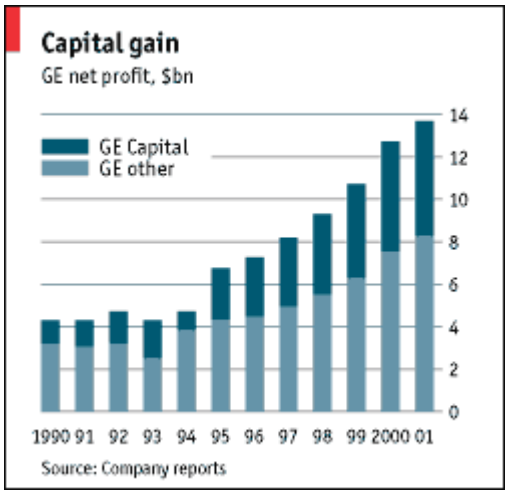
The worries about slowing growth mainly concern the industrial businesses. For over a year, the gas turbines and related services that GE has been selling into a booming power-generation market in America have accounted for over 100% of the firm's growth in operating profits from manufacturing, says Nicole Parent of Bank of America. That means that the combined profits of all other divisions have been shrinking. Soon those profits will dry up.

To be fair, GE has given plenty of warning about the power slowdown. But it keeps saying it will still deliver strong earnings growth this year and next. It plans to do this through a mixture of cost-cutting and other productivity improvements, better profits from cyclical businesses, such as plastics, as the economy picks up, and more acquisitions. Some investors do not like the sound of this mixture: the strength of the recovery is still in doubt, and GE is too big to speed up growth using acquisitions: after all, it already buys more than 100 companies every year—and investors no longer have any stomach for companies that grow by buying others.

Mr Gross suspects that GE has been making some of its money by taking bets in the financial markets, and points to the growth in short-term debts at the company last year as evidence. GE borrowed more short-term money as interest rates fell, goes the theory, which leaves it nastily exposed to the market should rates rise again—if what was really happening was unhedged betting. Bank analysts such as Tom Brown of bankstocks.com, a research firm, agree. “Everybody gets greedy,” says Mr Brown. GE, however, has a reasonable explanation for the rise in short-term debt. When GE Capital made

acquisitions and added other assets late last year, it was difficult to raise debt in the long-term markets. So the firm borrowed short-term money instead, and it is now refinancing those borrowings. GE says it never places the sort of bets Mr Gross and a variety of bank analysts think it has been making.

Even if the company is telling the truth—and it is impossible for outsiders to be sure—GE could be disguising its true health in any number of ways. What, for instance, should investors make of a $14 billion item on the company's balance sheet with no explanatory footnotes, entitled “All other current costs and expenses accrued”? Such accruals have grown rapidly in recent years. “Goodness knows what's in there,” says Doug Skinner, an accounting expert at the University of Michigan. It could be legitimate, it could be illegitimate, and it could be illegitimate in a good or a bad way, says Mr Skinner.



GE says it is ready to talk, so please call. But will investors really sleep any better after listening to what will no doubt sound like a reasonable explanation? The company is far too big and complicated for anybody to hope that peeling it like an onion will leave them with anything but a pile of rings on their plate.

A question of timing

GE used to feature on university courses as a model of probity. These days, it crops up in the seminars about earnings-manipulation. Everyone agrees that GE practises one form of earnings management: it times one-off asset sales to coincide with one-off write-downs or restructurings. The sales and restructurings are not necessarily related. A sale at GE Capital, for instance, might prompt a hunt round the whole of the finance arm for looming restructuring costs. Beyond this, the amount of profits-smoothing that GE indulges in is a matter of speculation.

GE also manages expectations about its earnings by managing its analysts. Analysts' estimates fall within an unusually tight range: every year, every analyst thinks GE is going to earn pretty much the same amount. In addition, the analysts' estimates all fall within GE's own range of earnings estimates, which is also unusually tight. This year, for instance, GE reckons that it will earn between $1.65 and $1.67 per share, a forecast that has not changed since December. GE says this is not a guess, but the result of a meticulous review at each of its businesses of the year ahead. The company meets its expectations year in, year out—it has missed its quarterly earnings target only twice in the past ten years. This, says GE, proves that it has a very good idea about how its businesses will perform.

Yet earnings management can be a black art. Take GE's first-quarter results. Because the gas-turbines business is about to slow down, it earned much of its first-quarter profits from cancellation fees. GE had said it would offset these by taking reserves against the future cost of restructuring the business. But the company failed to do so, fuelling worries about the capriciousness of its accounting policies.

Why might investors worry about all this? The main reason is that it may be only a small jump from this type of earnings management to the other, more malignant type, when companies are not smoothing, but covering up slowing growth or losses.

A working paper* by Mr Skinner and Linda Myers, which looked at 399 firms with unusually smooth and consistent earnings growth, found several interesting things. One was that these companies tend to enjoy high market valuations. Another was that there was evidence that they were smoothing bumpy earnings. A third was that the run of good luck had a tendency to end in an earnings shock. Finally, this shock had an unusually damaging effect on the share price.

From this, the authors concluded that managers who are in the habit of smoothing earnings have an especially strong motive to keep the good news coming, whether or not the business warrants it. Of course, this may say nothing about GE in particular. But the study does shed light on why investors might in general be nervous about companies whose profits are growing unusually smoothly.

The last bit of evidence being wielded by sceptics is the way GE has reacted to criticism. From its investor-relations department comes the usual soothing patter about the company's wonderful business model and its world-famous management initiatives (Six-Sigma, digitisation and so on). Under Mr

Immelt, GE has also increased the amount of financial information that it discloses. But it continues to treat analysts, journalists and other outsiders as if they either belong to the family of believers, or do not. Mr Immelt, meanwhile, has at times seemed both defensive and aggressive, a combination that is unlikely to help the share price that he says he cares so much about. He declined to be interviewed for this article.

What else can you expect of a company that has spent so long hearing how fantastically good it is, say GE's supporters? Investors, they suggest, should not draw the wrong conclusions from the fact that the company is misusing its muscle now. GE is simply not used to criticism.

Admittedly, Mr Immelt faces a dilemma. A few well-chosen words from him about how he is poring over, say, the company's internal-audit procedures might work wonders. The problem with that approach, however, is that it acknowledges that there may be risks. This is a particular worry for GE because the company balances to an unusually precarious extent on its reputation. Come at GE with a fresh pair of eyes, and risks pop up everywhere. Yet its share price tells you that the risks are much lower than at other companies. Despite the sell-off, GE's shares are still valued at 23 times its earnings. Citigroup, another American giant with a broad range of financial businesses, trades on 14 times earnings.

Over the long term, GE's performance will speak for itself (although not necessarily for the risks it takes to earn this money: remember the profit-smoothing). The trouble with GE, though, is that at any point in time, none of the evidence can tell you much about your act of investment faith. In recent months, the company has killed a good deal of that faith, as its share price has fallen. Were it to slide much further, GE would struggle to keep itself in one highly complicated piece.

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* “Earnings Momentum and Earnings Management”, University of Michigan, May 1998, revised April 1999

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The telecoms slump

No end in sight

May 2nd 2002
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How much longer can things go on getting worse?

ANOTHER week, another crop of bad news from the telecoms industry. Bernie Ebbers, the chief executive of WorldCom, was forced out (see article). The share price of Qwest, another heavily indebted American telecoms company, fell to an all-time low, after it had announced a first-quarter loss of $698m. Siemens, a German company, said it would cut 6,500 jobs in its telecoms-infrastructure division, on top of 10,000 layoffs already announced. Marconi and JDS Uniphase, two other network-equipment vendors, announced or gave warning of gloomy results.

Even as the broader economic climate begins to improve, the carnage in telecoms continues. “No bottom in sight,” is how Nikos Theodosopoulos, an analyst at UBS Warburg, puts it. He notes that, historically, the telecoms sector tends to recover six months later than the economy as a whole. But this time, he says, there is evidence of bigger structural problems in the industry that will not be solved by an economic recovery. That suggests the industry must undergo painful rationalisation before things start to improve.

How did this happen? Telecoms is an infrastructure-intensive business, and infrastructure takes a long time to build. So telecoms firms have to gamble on the level of future demand. In recent years, however, their bets—in both fixed and mobile telecoms—have gone spectacularly wrong.

In fixed-line telecoms, the problem is overcapacity. During the Internet boom, operators assumed that demand would continue to grow by 100% a year indefinitely. A vast construction programme ensued, fuelled by cheap capital. At its height, says Andrew Heaney of Spectrum, a consultancy, telecoms operators built seven years'-worth of capacity in a single year.

The result was a capacity glut, ferocious competition and frantic price-cutting. Traffic growth has not translated into extra revenue. Fixed-line operators have now cut their infrastructure spending to focus on picking up clients rather than expanding their networks. All of this is terrible news for equipment vendors. Two of the biggest, Nortel and Lucent, have cut around 50,000 jobs apiece in the past year or so.

Bankruptcies and mergers would appear to be the solution. But bankruptcies do little to solve the problem of overcapacity. When a steel firm goes bust, its mills can be knocked down; when a telecoms firm goes under, its network remains in the ground, so the capacity doesn't go away. Mergers, meanwhile, are unattractive in the current climate; the industry's woes mean there are few buyers. And mergers are also problematic for regulatory reasons. WorldCom's attempt to merge with Sprint, a long-distance operator, in 2000 was rejected as anti-competitive, since it would have created a giant with huge market power. Both that argument and America's rules stopping local operators merging with long-distance operators look harder to justify given today's turmoil and the rapid pace of technological change.

Conceivably, high-speed (“broadband”) Internet connections might someday generate the traffic needed to fill operators' empty pipes. But broadband has been slow to take off for a variety of reasons, so it would be foolish to expect it to make much difference any time soon.

Operators of mobile networks also made what turned out to be an ill-judged bet on future demand. With voice revenues stabilising, the industry hoped that new data services, piped over whizzy “third generation” (3G) networks, would provide growth. But consumers in most parts of the world have been far slower to embrace new data services than the operators had hoped. Worse, European operators hobbled themselves with huge debts by overpaying for 3G licences.

Investors now worry that mobile telecoms is merely a low-growth utility, rather than an industry on the verge of a new phase of explosive expansion. The uncertainty has had a knock-on effect on wireless-infrastructure vendors, who were banking on selling vast amounts of 3G equipment. Ericsson and Motorola, for example, are each laying off more than 40,000 workers.

Once again, consolidation might help to sort out the mess. Arguably, having dozens of mobile operators in Europe makes no more sense than having dozens of car makers. But consolidation is held back by regulation: as things stand, if a 3G operator folds or merges with a rival, it must give up its licence. European governments, however, are expected to change the rules soon to enable licences to be bought and sold. That will cause further pain as the market determines how little these expensive rights are really worth. But it should also help to dispel some of the continuing uncertainty around 3G.

In short, even though Internet traffic continues to grow and mobile phones remain popular, telecoms firms bet everything on a surge in demand that has so far failed to materialise. Backing out of these bets is proving to be very unpleasant. The carnage will continue for some time yet.

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Fiat

Last chance saloon

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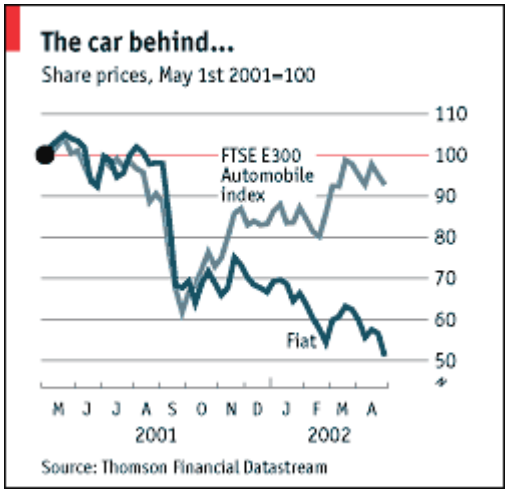
Fiat's car unit is having a horrid year. The rest of the group has problems too



WHEN Fiat wheels out its white-haired patriarch, things must be serious. This week, Gianni Agnelli issued a statement at the same time as the group was announcing an injection of *euro*1.8 billion ($1.6 billion) into its car division, Fiat Auto, which is owned 80% by Fiat and 20% by General Motors (GM). Mr Agnelli was trying to stop the slide in the company's share price (see chart). The honorary chairman—and head of the family that controls about a third of Fiat shares—said cars would remain a crucial part of the group. So why, you might ask, did Fiat include an option to sell Fiat Auto to GM after 2004 in the alliance contract signed two years ago?

Insiders admit that this year will be even worse for Fiat Auto than last year, when it made losses of *euro*549m. Blame collapsing markets in Brazil, Poland and Turkey, where Fiat has big operations. At home, collapsing prices are to blame: Fiat so dominates the Italian market that competitors will happily slash prices just to win a few sales. That is one reason why Fiat's latest white hope, the Stilo saloon, is falling 10% short of its sales targets. Other Fiat models are long in the tooth and losing out to fresher products from rivals. The result is that Fiat's European factories are working at only 75% capacity, when they need to hum at over 80% to make profits.

The problems at Fiat are not confined to cars, however. In the late 1990s the group made big investments in non-automotive businesses, a strategy that made it more diverse, but also left it with too much debt. Worse, some of the acquired businesses have proved disappointing.

Basket Case?

An example is Case New Holland (CNH), a leading maker of agricultural and construction machines. It was created in 1999 when Fiat bought Case, an American company, for $4.6 billion and scrunched it together with its own New Holland business. CNH still accounts for around *euro*5 billion of Fiat's *euro*6 billion of net balance-sheet debt. Although CNH has managed respectable cost savings, mostly by cutting its large number of plants, its financial returns have been poor. In retrospect, say analysts, Fiat bought Case expensively at the top of the cycle. Worse, it did the deal in a hurry because it feared that John Deere, a rival, would snatch the prize. As a result, Fiat failed to spot a $1 billion hole in the Latin American part of the business and another big one in the credit subsidiary.

AP

Worries about Fiat's debts have done almost as much as losses on cars to drive down the share price. Although the declared net-debt figure seems manageable, Fiat's industrial divisions are actually burdened with around *euro*10 billion of overall debt, much of it short-term and expensive. A disposal programme is not helping much. Last year, for instance, Fiat failed to find a buyer for Magneti Marelli, its struggling car-components business.

Paolo Fresco, the group's chairman, plans to raise at least *euro*2 billion from asset sales this year. Added to the proceeds from an already completed *euro*1 billion rights issue, this should reduce net debt to *euro*3 billion. Analysts have speculated that everything from military-vehicle production to

Teksid, Fiat's foundry business, could go on the block. The group could yet decide to sell Comau, which makes robots for car makers such as Ford and GM, or Iveco, its truck and bus division.

Fix It Again, Tommaso

Whatever the combination of disposals, a little-noticed trend is set to continue: Fiat and the Agnelli family are putting relatively less investment in cars. Despite Mr Agnelli's declarations, the family has been steadily shifting its fortune elsewhere. Fiat's future increasingly lies with businesses providing either more stable returns or better growth than cars can offer.

Consider two big recent investments. In January 2001 Fiat bought out minority investors in Toro, Italy's third-largest insurer, thus taking it private. Toro has a stake in Banca di Roma and access to the bank's distribution network. Although it failed in a bid to merge with two smaller insurers earlier this year, Toro is profitable, cash-rich and has plenty of potential to grow by itself. Italy is expected to develop a huge market in private pension schemes, with big insurers set to benefit most.

Fiat has also moved into the utilities market to acquire another cash cow. Working closely with Electricité de France last year, it mounted a stockmarket raid to grab control of Montedison, an energy-to-chemicals conglomerate that owns Italy's biggest private power producer. This business is profitable and its prospects are bright. According to industry forecasts, Italian electricity demand will grow by a third over the next decade or so.

As Fiat waits for these acquisitions to boost its bottom line, insiders are confident that the car business, which accounts for 41% of total group sales, will pick up as new products arrive and the Stilo stumble is cured through a cheaper version for the cost-conscious Italian market. Fiat Auto's joint ventures with GM, which make engines and buy parts, should soon start to reap economies of scale by, for instance, making 3m GM and Fiat small cars with common underpinnings.

And if Fiat Auto continues to underperform? Mr Agnelli has indicated that the car maker will be sold only over his dead body. But he is, after all, 81. And if Fiat Auto disappoints as it so often has in the past, the only way out may be to sell the world's seventh-largest car company to GM; and be content to be the biggest shareholder in the world's biggest car maker.

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Business in Sicily

The EU's third-world island

May 2nd 2002 | PALERMO
From The Economist print edition

No water, no power: just two of the problems Sicily's companies face

SICILY'S main airport is called Falcone-Borsellino in memory of two anti-mafia magistrates blown up in the line of duty. Gang wars and mafia attacks on public servants have bloodied the Italian island. Yet for most of its firms, the daily fight to keep upright in an inhospitable business climate is even tougher than fending off Cosa Nostra's attentions.

Among the problems companies face are erratic water and electricity supplies, a hostile public administration and a widespread notion that jobs carry the right to monthly pay but no corresponding duty to work. Poor transport and the sheer distance of Sicily from the heart of Europe also help to explain the island's 20% unemployment, more than twice the national average, and why many investors steer clear, convinced that the place is more third world than first.

Sicilian firms are probably unique in the industrialised world in having piped water only one day in three. In Caltanissetta, central Sicily, the factory that produces Averna, a herbal alcoholic *digestivo* drink, is sometimes without piped water for a week. The plant has spent heavily on storage tanks, drilling wells and installing purifiers. “What other drinks firms face such extra costs?” asks Francesco Rosario Averna, who heads the business. Water was also once a problem for ST Microelectronics, a Franco-Italian group that makes memory chips in Catania. The problem only went away when the city authorities were persuaded to lay pipes especially for the company, Sicily's biggest industrial employer with over 4,000 workers.

Patchy electricity is another headache. “Not a day passes without blackouts,” complains Mr Averna. Sometimes these last a few seconds, sometimes hours. ST Microelectronics also had problems with power supplies, until it installed a second high-voltage line from the grid.

Despite all this, the chip maker's managers say that relations with the authorities are good. But many companies have lost patience with local governments that toss bureaucratic barriers in their way and fail to pay their dues. Last year EAS, the water company owned by the regional authorities that is letting Mr Averna down, received only two-thirds of the money owed by its customers. Heavily indebted EAS gripes that town councils are among the worst offenders in not paying bills. It is not alone. In March, the island's private-sector bus companies sued to recover *euro*80m ($70m) owed by regional authorities.

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Takeovers in South Korea

One step forward, one step back

May 2nd 2002 | SEOUL
From The Economist print edition

At last, GM bags Daewoo Motor. But Hynix eludes capture

THE government is desperate to sell the most troubled of South Korea's big companies to foreigners. This, ministers believe, is the best way to accelerate the corporate restructuring begun in the wake of the Asian financial crisis in 1997, and to clear the way for more sustainable economic growth. This week, after months of on-off talks with foreign suitors, the government's plans moved a big step forward, and then an equally big step back.

On April 30th General Motors (GM) signed a contract to buy the bankrupt Daewoo Motor. But on the same day, the board of Hynix, a cash-strapped memory-chip giant, shocked the markets by rejecting a proposed takeover by Micron Technology, an American competitor. Micron had offered to pay about $3.4 billion for Hynix's core memory business, and to take a minority stake in the non-memory arm. Analysts predict that the government will put pressure on creditors to rescue a deal with Micron or seek a new buyer, as liquidation is too risky to contemplate in an election year.

GM's deal with Daewoo Motor marks the end of an even longer and more painful process. Ford almost bought the car maker two years ago, but pulled out after deciding that Daewoo would be too hard to turn round. GM had been talking with Daewoo for over a year. It has agreed to buy two of the company's four domestic car plants, a factory in Vietnam, a parts unit in the Netherlands and nine overseas-sales arms (all in Europe except one, in Puerto Rico of all places). Between them, the two domestic factories can churn out a combined 530,000 cars and 30,000 commercial vehicles a year.

GM has struck a good deal. Together with various undisclosed partners, it will hold a 67% stake in a new company, tentatively named GM-Daewoo. The American car maker will pay $251m for its own stake of 42%, but it will also assume $573m of Daewoo Motor's debts.

The acquisition is a key part of GM's global expansion. The company has been trying to strengthen its foothold in Asia for some time. Buying a presence in South Korea was seen as particularly urgent, since imports account for only 3% of the 1.5m cars sold in the country each year. GM hopes to use Daewoo's production lines to make budget cars that will be sold under the Daewoo brand in most markets.

But GM has much work to do to rebuild Daewoo's damaged brand image and domestic market share, which hovers around 10% after reaching a high of 37% in 1998. GM has to fill holes in product lines by introducing sport-utility and multi-purpose vehicles, says Nick Reilly, former chief executive of Vauxhall, GM's British subsidiary, and chief-executive-designate of GM-Daewoo now that he has sealed the deal.

His management team can expect trouble from South Korea's aggressive unions along the way. In a sign of things to come, the signing ceremony was moved to a secret location after a group of union activists occupied the hotel where it was due to take place.

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Frequent-flyer miles

Fly me to the moon

May 2nd 2002
From The Economist print edition

The earning and spending of frequent-flyer miles has become a big business—perhaps too big

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Reuters

30m miles well spent

FREQUENT-FLYER miles have come of age. Twenty-one years ago this week, American Airlines launched AAdvantage, the world's first mileage-based frequent-flyer programme. Today, some 100m people around the world belong to at least one such scheme. One in three American adults collects frequent-flyer miles. But how safe are they?

Airlines first introduced mileage schemes to build up customer loyalty. They also provided a vast marketing database, allowing airlines to track a passenger's travel history and to focus advertising. Today, however, almost 50% of miles are earned without even leaving the ground. The biggest earners are credit-card spending and telephone calls, but car rental, hotels, share-trading or refinancing a mortgage all offer extra opportunities to top up your miles. In America you can even get miles on your income-tax payments, if you pay by credit card. The world's top frequent flyer, reputedly a publishing executive who charges his firm's postage bill to his own credit card, has racked up 25m miles—enough to fly London to Sydney return 250 times.

Free tickets purchased with frequent-flyer miles account for an average of 8% of airlines' revenue passenger miles. But the proportion varies by airline. Last year, free tickets accounted for an estimated 10% of the miles flown by American Airlines' passengers, up from 8.4% in 1996. British Airways will not reveal how many free seats it gives away, but it is thought to be stingier.

On most airlines, one mile is earned for every mile flown. But what is a mile worth? Airlines sell miles to partner companies, such as credit-card firms, at an average of just under two cents a mile. Since last year some American airlines have been selling miles directly to passengers, at three cents per mile, to allow them to top up their accounts. But if you make the best use of your miles, such as flying first class across the Atlantic, the market value can be up to nine cents a mile.

The miles that employees earn flying on business are a big fringe benefit that the state would love to tax. But valuing such perks and enforcing the tax is currently too difficult. In February America's Internal Revenue Service announced that, for now, frequent-flyer miles would not be taxed.

Frequent-flyer junkies treat miles almost like a second currency, but they are not freely tradable. The fine print of all programmes says that you cannot sell, buy or barter miles. However, as with any controlled currency, there is a thriving black market. Brokers, such as Award Traveller, will buy your miles at a discount (by paying you to redeem them for a ticket in the name of one of their customers). Airlines try to crack down on such sales. If you are found out they can confiscate the ticket and close your account.

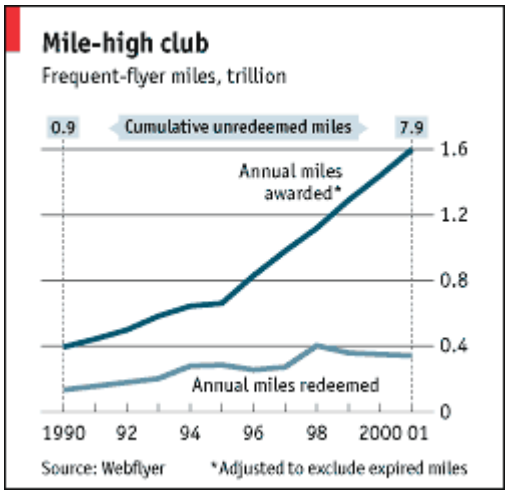
Once it was all a gimmick

Frequent-flyer miles started as a marketing gimmick, but the sale of miles has become a nice earner for airlines. In 2001, they sold roughly $10 billion-worth of miles to partners, such as credit-card firms. This boosts airline's revenues; and the marginal cost of giving away free seats that would otherwise be empty

is minimal.

But what about the future financial liability arising from unredeemed miles? Airlines include a contingent liability in their accounts, to cover the future cost of unredeemed miles. They value them at marginal cost—a lot less than the price they sell them for. From a strict financial point of view, there is little risk to the airlines. The liability of unredeemed miles cannot cause an airline to go bust, because it can limit the number of free seats available. However, there is a looming problem for frequent flyers themselves.

It is becoming easier to earn miles, yet the number of seats is limited. Randy Petersen, editor of *InsideFlyer*, a magazine for frequent flyers, has some alarming figures on his website. The total number of miles awarded each year by airlines worldwide has doubled over the past five years; but miles redeemed have increased by only one-third (see chart). In 2001, over four times as many miles were earned as were redeemed, and miles do not expire so long as members have earned or used them in the past three years. As a result, airlines' liability surged to almost 8 trillion miles by the end of 2001. At the current rate of redemption, it would take 23 years to clear this liability even if no new ones were issued.



Already, too many miles are chasing too few available seats. After September 11th there were lots of empty seats, making it easy to get a free flight. But as travel returns to normal, many travellers complain that it is once again difficult to get free seats or upgrades on the flights they want. Miles can also be used to buy holidays, car rental and goods such as books and CDs, but these purchases currently account for only 3% of redemptions.

Airlines could respond by increasing the number of miles required for a free flight, as they did in the mid-1990s. Some of them have already become more flexible. American allows members to pay extra miles to claim a free seat without the usual restrictions on seat availability and date of travel, if there are empty seats on a plane. But increasing the miles needed for a ticket or making free tickets harder to get both have the effect of devaluing frequent-flyer miles.

The fine print of frequent-flyer programmes makes chilling reading. The rules for AAdvantage warn that “the accumulation of mileage credits does not entitle members to any vested rights...In accumulating mileage, members may not rely on the continued availability of any award.” The clear lesson is: use your miles while you can. US Airways has launched a deal where, for a mere 10m miles, you can buy a seat on the first private spacecraft to take passengers into space, scheduled for 2004. Why wait?

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Face value

Yesterday's man

May 2nd 2002
From The Economist print edition

WorldCom's Bernie Ebbers typified the lionised chief executive. Now he is an ex-lion

IN HIS cowboy boots and stetson hat, Bernie Ebbers made a splendid cover for any magazine that wanted to be abreast of the telecoms revolution of the late 1990s. His background, too, had just the sort of mix of hard grind, modest intellectual prowess and sporting vim that America likes in its hero-bosses. Born in Canada, he worked as a milkman by day and a bouncer by night. He dropped out of college twice, eventually graduating with a degree in physical education from Mississippi College, where he had a basketball scholarship.

With this perfect pedigree, Mr Ebbers coupled a talent for deft deal-making and cosmic quantities of chutzpah. He also picked out early the industry that was to be a centre of the late-1990s bubble. After a bout of buying and selling hotels and motels, Mr Ebbers spotted the opportunities created by the break-up of AT&T, America's telecoms giant.

He began buying long-distance telephone time as a commodity and reselling it through a company called Long Distance Discount Service (LDDS). Before long, the business was prospering. After renaming it WorldCom in 1995, Mr Ebbers embarked on an acquisition spree. Within a few years, he had gobbled up more than 75 companies to become a brand-new telecoms giant.

Such a fervour of corporate takeovers invariably breeds adulation. The bankers and brokers all puff up their champion: the bigger his reputation, the higher his share price, the greater his buying power and the more luscious their eventual fees. The press, for whom a takeover battle makes far more exciting copy than the humdrum daily business of minding the shop, happily collaborates. And the smoke and mirrors of acquisition accounting offer plenty of scope for creative rearrangement of the balance sheet.

No wonder that, at the peak of the telecoms frenzy, Mr Ebbers was the subject of as much admiring prose as four other giants of the era—Enron's Kenneth Lay, Chris Gent of Vodafone, Jean-Marie Messier of Vivendi and PCCW's Richard Li—put together. *Forbes* magazine listed him as the 174th richest American. *Time* included him in its cyber-elite. George Gilder, an Internet guru, once announced in the pages of *Wired*, a fashionable magazine of the dotcom days: “It's all over. Bernard Ebbers of WorldCom has won.”

Downhill all the way

Mr Gilder was hailing WorldCom's audacious purchase of MCI, America's second-biggest long-distance carrier, in 1998, beating off Britain's national telecoms giant, BT. And to be sure, pretty soon it was all over—but for Mr Ebbers. In 2000, he tried to buy Sprint, another American rival, but was blocked by antitrust regulators on both sides of the Atlantic, who feared the merged company would dominate global Internet backbone services. He never recovered his élan.

With the buying spree over and demand for data and Internet services dropping like a brick, it was suddenly clear that WorldCom had no alternative strategy. Parochial, stubborn, preoccupied with penny-pinching (but willing to splurge himself), Mr Ebbers was a difficult man to work for. His response to most problems was to cut costs. In one particularly dire decision, he merged UUNET, the Internet-backbone unit that carries 40% of all Internet traffic and had been run as an independent company, into the main business division. That destroyed UUNET's brand and its staff morale.

As for Mr Ebbers's reputation, it has been eroded by dwindling revenue projections, a shrivelling share price, the prospect of a probe by the Securities and Exchange Commission into the company's accounting practices and the hair-raising discovery that he had borrowed $366m from the company to cover losses incurred by buying WorldCom shares. On April 30th, under intense pressure from the board and large shareholders, Mr Ebbers resigned as chief executive of the company—whose market capitalisation, at $7 billion, is a mere 4% of its value at its peak (see chart).

Mr Ebbers's replacement as chief executive is John Sidgmore, architect of UUNET. He will doubtless end up selling WorldCom: its business division, at least, remains valuable, even if competition from the resurgent Bells has gobbled up the consumer market. But he may not have much time. Carol Levenson of Gimme Credit, a credit-research company, calculates that WorldCom faces around $3.1 billion of maturing debt next year, most of it in the first half, but has only $1.6 billion in cash. The company is projecting (optimistically, she thinks) $1 billion in free cashflow this year and $1.25 billion next year. That, she says, is “too close for comfort”.

Mr Sidgmore, who has devoted himself to his charity work since UUNET was subsumed in the business division, is everything that Mr Ebbers was not: thoughtful, intelligent and analytical, with a firm grasp of strategy. He lacks Mr Ebbers's charisma, chutzpah and cowboy boots. He may thus be the right man for the moment—as, to be fair, Mr Ebbers may have been for his time. Those who once lionised Mr Ebbers now rubbish him, forgetting his genuine achievement: the high-speed consolidation of the fragmented American telecoms industry.

The fashion for flamboyance in chief executives is definitively over, at least until the next boom arrives. A new wave of bosses has arrived: a recent survey by Chief Executive/Spencer Stuart found that a quarter of the chief executives of Fortune 700 companies have been in their jobs for less than a year. These newcomers will have to concentrate on running the business rather than smoke and mirrors if they are to prosper in the harsher world of a slow recovery. In a quiet market, it is old-fashioned skills of cautious accounting, attention to detail and a strong sense of strategy that matter—more than the equally old-fashioned skill of striking a fast deal.

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Company accounts

Badly in need of repair

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From The Economist print edition

Enron and others have shown how easy it is to manipulate companies' financial statements. Can it be made more difficult?

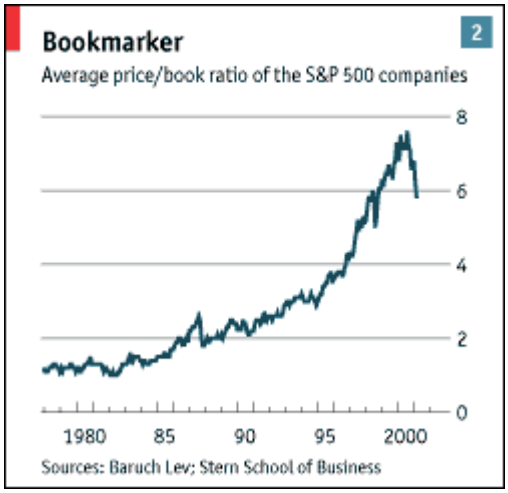
BODO SCHNABEL, the boss of Comroad, a navigation-technology company listed on Germany's Neuer Markt, treated his accounts with wild abandon. In 1998 the company invented two-thirds of its total revenues and backed them up with the name of a non-existent client in Hong Kong. By 2000, 97% of Comroad's revenues came from the imaginary company, the existence of which its auditor, KPMG, did not bother to verify.

Comroad is just one of a series of accounting scandals that have badly damaged investors' confidence in financial statements. Companies such as Waste Management, Cendant, Xerox and, of course, Enron, have lied wholesale to investors who have now become suspicious of all accounts. The share price of General Electric (GE), the world's biggest company by market capitalisation, has fallen by some 23% this year, due in part to concerns about its accounting methods (see article). Blacklists have circulated round the City of London and Wall Street. One listed all companies whose chief financial officers had been recruited from one of the Big Five accounting firms.

Many investors now believe that companies can manipulate their accounts more or less at will, with the aim of producing profits that increase steadily over time. Provisions are bumped up in good years and later released, or the value of an acquisition is slashed; there are plenty of tricks. In the dotcom years, finance directors resorted to so-called pro-forma numbers, which strip out negative items from the income statement.

The primary purpose of financial statements is to show the underlying economic performance of a company. The balance sheet provides a snapshot, at a moment in time, of the assets, liabilities and capital of the business; and the income statement, or profit-and-loss account, shows the difference between total revenues and total expenses. The auditors vouchsafe that these present a fair view, acknowledging the subjective nature of some of the measures behind the accounts. The independence of the auditors guarantees, in theory, that “fair” is just that.

Somewhere along the line, though, things seem to have gone wrong. “Our financial reporting model is broken,” said Joseph Berardino, former head of Andersen, Enron's auditor, last year. Designed in the 1930s for an industrial age, financial statements, he argued, look backwards to historic costs; they give investors little clue about the future. Companies cannot include internally-produced software, drugs or brands in their balance sheets because they are intangible assets. That has led to an increasing gap between the value of companies as measured by the stockmarket and the value measured by their accounts (their book value), although the difference has contracted of late along with the market values of technology companies (see chart 2).



Off-balance-sheet holes

Accounts certainly rely too heavily on historic costs. But what concerns investors far more is the stuff that lurks beyond the balance sheet. Although numbers recorded on the balance sheet are often misleading, investors can adjust them by using information that companies are obliged to disclose elsewhere. The worrying thing about so-called “off-balance-sheet” items is that they can appear suddenly out of nowhere, without warning. There may be clues in the footnotes, but few people pay close attention to these impenetrable bits of legalese.

Special-purpose entities (SPEs) are a sort of non-consolidated, off-balance-sheet vehicle that have some legitimate uses, such as, for example, the financing of a research and development partnership with another company. They can, however, also be used to shove nasty liabilities and risks into corners where, with luck, nobody will see them. At the moment, investors are assuming that they are being used mostly for the latter purpose.

In November 2000, Enron restated its financial statements, reducing its profits by $591m over four years and increasing its debts by $628m. Most of the restatement came from the consolidation of two SPEs. America's standard-setter, the Financial Accounting Standards Board (FASB), points to Enron's restatement as evidence that it was the energy trader's disobedience that was the problem, not the rules on special-purpose entities.

Another of Enron's special-purpose vehicles, however, called LJM2, stayed off its balance sheet in accordance with FASB standards. And there are many more SPEs out there, notably off the balance sheets of companies which securitise (ie, repackage and sell on to investors) large chunks of their assets.

Another example of off-balance-sheet deceit is the dry-sounding yet potentially dangerous phenomenon of commitments, a variety of contingent liability. A company commits itself to a future contingent payment but does not account for the liability. Telecoms-hardware manufacturers, for example, often guarantee bank loans to important customers in return for buying their products. That is fine so long as the business is healthy, but if a company enters into such a transaction purely to lubricate its own cashflow, the commitment can become a risk. At the moment, according to American, British and international accounting rules, many varieties of commitments are mentioned only in footnotes since there is, in theory, only a low probability that they will crystallise.

Operating leases, through which a company agrees to rent an asset over a substantial period of time, make up most off-balance-sheet financing. Airlines use them to clear their accounts of large numbers of aircraft. The practice helps to avoid tax, but it also results in a drastic understatement of the airlines' debt, according to Trevor Harris, an accounting analyst at Morgan Stanley Dean Witter. In 1997, one-third of the aircraft of the five biggest American airlines were treated as operating leases rather than as assets.

Needless to say, this is all done in accordance with accounting rules. Standard-setters have come up with hundreds of pages of rules on operating leases, but they have failed to get companies to admit what any analyst knows: that airlines reap the economic risks and rewards of their aeroplanes and ought to treat them as assets.

Unlike off-balance-sheet financing methods, most of which date from the last 15 years or so, the trick of

recognising revenue too early (or booking sales that never materialise) is an old one. Global Crossing, a bankrupt telecoms-equipment company now under investigation by the Federal Bureau of Investigation and the Securities and Exchange Commission (SEC), is accused of swapping fibre-optic capacity with a competitor as a way to manufacture revenue. And according to the SEC, Xerox, a photocopier company, wrongly accelerated the recognition of equipment revenue by over $3 billion. Standard-setters admit that no country has adequate rules on the recognition of revenues. A solution in the meantime may be to look at cash, which is far harder to disguise or invent. Comroad duped its auditor about its revenues, but it could not conceal the fact that its cashflow was negative.

The standard-setters

A different sort of problem lies in the very nature of American accounting standards. Companies always think of new ways to get round the rules, and the standard-setters' job is really an unending attempt to catch up. But the body of accounting rules in America has become both too detailed and too easy to circumvent. Until the 1960s, standards were simple and based on broad principles. With the advent of class-action lawsuits against companies whose share prices had tumbled, however, audit firms demanded detailed, prescriptive rules to help them in court. As a result, accounting standards in America have multiplied into vast tomes.

America's web of accounting rules, or generally accepted accounting principles (GAAP), date from the 1930s and are now produced by FASB, a private-sector body staffed by accountants. Elsewhere, accounting standards are set by private-sector groups or, in some cases, especially in Europe, directly by governments. Accounting rules outside America lean more towards principles, particularly in Britain, where the importance of providing a “true and fair” view of a company's performance overrides specific rules.

The body of accounting rules in America has become both too detailed and too easy to circumvent

Fights over new accounting standards do not usually grab headlines. But companies care a lot about changes to accounting rules, since at one swoop their numbers may fall under a far harsher light. They lobby intensively behind the scenes, often with the help of one of the Big Five audit firms. Whether or not a standard-setter has the ability to withstand pressure depends on its legal status, the independence of its funding, and the country's overall culture of corporate behaviour and influence.

FASB is under attack over Enron's demise. Its efforts to sort out consolidation accounting, an issue directly relevant to the energy-trader's downfall, had been going on for 20 years, or for a large part of its 29-year history, with no conclusive result. The argument centres around when a company must add all the assets and liabilities of a related entity into its books. Harvey Pitt, the chairman of the SEC, has criticised FASB for taking so long to make up its mind.

The board has tried hard to address off-balance-sheet abuses. Too many times, though, it has run up against corporate pressure applied through Congress, not least in the case of special-purpose entities, the trick that Enron used. In 1999-2000, FASB was moving towards a concept of effective control rather than ownership to determine whether or not a special-purpose entity should be consolidated into a company's accounts. If the more subjective idea of control is used for standards on consolidation, as it is in Britain and elsewhere, it is easier for an auditor to exercise his judgment and insist that an entity be brought on to the balance sheet.

In trying to address off-balance-sheet abuses, FASB has too often run up against corporate pressure applied through Congress

But FASB's initiative would have created difficulties for companies that rely on such entities. Richard Causey, Enron's former chief accountant, wrote in to object. So did Philip Ameen, head of Financial Executives International, a corporate lobby group, and a top financial officer at GE, itself a heavy user of SPEs. In January 2001, nine months before Enron went bankrupt, FASB announced that it was putting the project on hold.

In the 1970s, Congress mostly left FASB alone, with one big exception: oil and gas accounting. In 1978, the oil and gas industry persuaded it to stop the SEC from forcing any company to use an unflattering method of accounting for drilled holes. Congress became involved in accounting issues again during the savings-and-loan crisis of the late 1980s. The result was that the industry's bad-debt problems dragged on for longer than they might have done.

In recent years, the most blatant political intervention in the standard-setting process has been over the stock options that many companies grant to their employees. In 1993, FASB proposed that companies should account for stock options as expenses. The following year, Congress threatened to take away its standard-setting powers if it did not water down its proposal. In the end, FASB settled for footnote disclosure. Under heavy pressure, says Lynn Turner, a former chief accountant of the SEC, “they had no choice but to fold, like a cheap tent.”

Another problem, says Mr Turner, is that a lot of standard-setting power has been given to the Emerging Issues Task Force (EITF), an offshoot of FASB whose mission is to respond quickly to new accounting problems. The EITF was set up in 1984 with a membership drawn from industry and the accounting profession. Whereas a key part of FASB's mission is to serve the public interest, the EITF has no explicit duty to shareholders or the public.

As far back as the late 1980s, the SEC asked the EITF to look at special-purpose entities, worried that they might lead a company to become overly leveraged without investors realising it. At a meeting in 1990, the group voted unanimously to do nothing to change the status quo. After an appeal from the SEC's chief accountant, Edmund Coulson, three EITF members agreed to change their vote.

The outcome, eventually, was a rule by which a company can keep a special-purpose vehicle off its balance sheet as long as an independent third party owns a controlling equity interest equivalent to at least 3% of the fair value of its assets. That number, post-Enron, is now judged to be too low, and FASB may raise it to 10%.

Mr Turner believes that the EITF should be given an explicit mandate to serve the public interest. Its rulings should be approved by FASB as a matter of course. At present, part of FASB's controlling board of trustees comes from industry groups and its funds from audit firms, industry and financial groups. A new bill from Congressman Billy Tauzin, aiming to boost the independence of FASB, would hand the responsibility for its funding to the Treasury, which would levy compulsory fees on companies and accounting firms.

In Britain, a series of business scandals in the 1980s, most notoriously Polly Peck, a conglomerate which manipulated its foreign-exchange earnings, convinced the corporate world that accounting rules had to get better. The Accounting Standards Board (ASB), set up in 1990, declared war on off-balance-sheet chicanery. It produced a new rule, FRS5, which requires the substance of an entity's transactions to be reported in its financial statements, regardless of legal form.

The ASB has recently enraged businesses in Britain with a new standard, FRS17, which will force them to disclose and recognise the full effect of pension-fund gains and losses. Companies hate the standard because it will bring the volatility of financial markets into their earnings. They have tried hard to get politicians involved, says Mary Keegan, the standard-setter's chairman, but the ASB has not come under government pressure to scrap or change the standard.

A new private-sector standard-setter in Japan, the Financial Accounting Standards Foundation, gives investors some hope of better standards there. Its predecessor, the Business Accounting Deliberation Council, appeared powerless to pass any standard that would damage the suffering Japanese economy. Japan's accounting rules contain loopholes that allow companies to hide the economic substance of their performance. For instance, the recent guideline on fair-value accounting, which decrees that companies must show equity holdings at their market value, also contains a provision that allows them to avoid writing down shares if they think that they will soon recover in value.

Do the right thing

If accounting standards are to improve, it is probably the International Accounting Standards Board (IASB), originally established in 1973, which will lead the way. America does not yet recognise its rules; companies that wish to raise capital in American markets must still reconcile their accounts with GAAP. But the IASB gained a lot of influence in 2000 when the European Commission decided that all companies in the European Union must report according to its standards by 2005.

When he was head of the ASB, Sir David Tweedie, now chairman of the IASB, successfully fought off attempts by business to influence the standard-setting process. He is determined to do so again. He believes, for instance, that the effect of giving stock options to employees should be counted in companies' accounts, not just mentioned in footnotes, as they are at the moment. The IASB will soon

publish a draft proposal for a global standard on stock-option accounting. Like FASB, it will face strong opposition, including, crucially, from the European Commission, which wrote this January to say that it would prefer the IASB to concentrate on better disclosure of stock options rather than a new conceptual approach.

Sir David also wants to bring in a new international standard on pensions, similar to FRS17. Like FASB, however, the IASB would be better positioned to push through high-quality standards if it did not rely on business and big audit firms for its funding. Earlier this year it was badly embarrassed by an e-mail showing that Enron expected to be able to influence its standards in return for cash.

If accounting standard-setters have their way, financial statements are likely to become far more volatile in the future. Representatives from some of the world's most influential bodies—including those of America, Australia, Britain, Canada and the IASB—have published proposals to value all financial instruments at market value rather than at cost. Bank loans and deposits, as well as traded financial instruments with easily obtainable prices, would be marked to market. Because changes in balance-sheet values would be passed through the income statement each year, this would be sure to make corporate results far jumpier.

Proper accounting for pension schemes, along the lines of FRS17, would have the same effect. The IASB is working on the recognition and measurement of intangibles, as is FASB. Again, if intangible assets are recognised on balance sheets, they will add volatility to income since, on the whole, their value tends to fluctuate more than that of tangible assets.

Changes such as these are the ultimate answer to people who criticise accounts for being industrial and irrelevant. Standard-setters have already started to crack down on off-balance-sheet abuses and they have more backing to do so, post-Enron. Companies will fight against either sort of change. They want their earnings to move gradually upwards, not to jerk around, and they do not want the fact that they use volatile financial instruments to be reflected in their results, even if the volatility is real. Standard-setters should take the views of companies and governments into consideration. But if future Enrons are to be avoided, they must be given the freedom to force companies to reveal far more economic reality in their accounts than they do at present.

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Bank mergers

Scent of a banker

May 2nd 2002
From The Economist print edition

Wounded investment banks invite takeover speculation

A PUBLIC apology on April 26th by David Komansky, chief executive of Merrill Lynch, for ethical breaches by some of his securities analysts, may deflect some of the bad publicity that has hit Merrill's share price and that may even threaten its survival as an independent firm. There might, too, be some relief at Merrill now that an investigation by the Securities and Exchange Commission (SEC) into conflicts of interest has widened to other firms. This week the SEC asked all big investment banks to hand over records of internal messages that might have crossed the Chinese wall between analysts and investment bankers. Merrill is still under investigation, though, by New York state's attorney-general, Eliot Spitzer, and it might yet face criminal charges.

Loss of reputation is one of the swiftest and most damaging of hazards to hit a financial firm. It has caused the sale of several dented firms in the past—notably Bankers Trust (sold to Deutsche Bank), Union Bank of Switzerland (combined with Swiss Bank into UBS) and NatWest (bought by Royal Bank of Scotland). Besides Merrill, two other banks, CSFB, owned by Credit Suisse, and J.P. Morgan Chase, have lately seen their reputations suffer. CSFB was fined $100m by the SEC for allegedly misleading investors on offerings of technology shares. J.P. Morgan is being investigated for possibly dodgy off-balance-sheet ventures crafted for Enron, the fallen energy giant.

Rumours of bank mergers are always in the air, but now they are latching quickly on to wounded targets. The game of matching likely pairs has fresh material to play with. Current textbook theory cites Citigroup as the model of a truly global corporate and investment bank. Citigroup is vast: the biggest bank in the world by market capitalisation ($225 billion). Thus, no possible combination of other banks seems too big to contemplate these days. Even Citigroup itself is said to be on the prowl in Europe, for asset management and investment banking. Why not clamp UBS's $38 billion of capital to its own $76 billion to create an even bigger monster? Citigroup says modestly that it regards its “footprint” as big enough.

Among the wounded, CSFB has been paired off by rumour-mongers in Europe with Barclays, Deutsche Bank and even UBS. Citigroup might also be interested, say some, especially since John Mack, Morgan Stanley's former chief executive, who was hired to improve CSFB's culture and its reputation, might want a broader canvas to paint on. Investment bankers at CSFB, for what it is worth, think that Mr Mack is ruthlessly cutting the firm—particularly its ineffective European and East Asia operations—largely in expectation of a sale, perhaps to Deutsche.

J.P. Morgan Chase is an unlikely takeover target, but the giant entity made up of four former money-centre banks appears to have lost its way. It is weak in equities and has relied overmuch on trading in derivatives and on highly-leveraged transactions. So why not invite Goldman Sachs—with perhaps the best managers on Wall Street—into a partnership, as Citigroup did in 1998 with Salomon Smith Barney?

As for Merrill Lynch, it has for some while been mooted as a possible target for Deutsche. But the German bank returned indifferent results for the first quarter (see article). Now a merger would come more from weakness than strength. Deutsche still needs a stronger American presence to fulfil its global ambitions, but its share price has sagged. UBS, too, might dust off plans for Merrill Lynch. Although it would do better to consolidate what it has, after management upheavals last year, its chairman, Marcel Ospel, is “restless”, says a former colleague; besides, he has built his career doing such deals.

None of these plans does much for consolidation in Europe. That is not such a surprise. Cross-border mergers of banks in Europe would produce few short-term gains, only expenses. Take Deutsche and Britain's Lloyds TSB, whose names have recently been linked. A merger would be wonderful for Deutsche's shareholders, who have been stuck with returns on equity half those at Lloyds TSB, with its mainly British retail operations. But what is the attraction for shareholders of Lloyds TSB, unless they share Deutsche's dream of a world-straddling giant?

Other more thinkable cross-border mergers in Europe also founder on several counts. First, there is no genuine pan-European market yet for financial services. Domestic business is generally more profitable than cross-border business. Second, there are fewer opportunities to cut overlapping branches and employees. Third, many banks are national champions, harbouring a certain stubborn pride. Germany's HypoVereinsbank was able to buy Bank Austria when Austria was a political pariah and its banks were under investigation by Brussels: such chances are rare. What is more, second-tier banks are snooty about other second-tier ones. BNP Paribas or Société Générale, French champions, are more likely to look to America—at Lehman Brothers, for example—than at German or Italian banks. This standoff will persist until some of the champs stare extinction in the face.

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Deutsche Bank

Mr Ackermann expects

May 2nd 2002 | FRANKFURT
From The Economist print edition

Germany's biggest bank reshapes itself, again

AP

Ackermann and Breuer: what's a bad quarter between friends?

ON MAY 23rd Deutsche Bank will acquire a new boss, when Josef Ackermann, a Swiss, replaces Rolf Breuer as “speaker” of its *Vorstand*, or management board. Mr Ackermann's stamp on Germany's biggest bank is already visible. Since January a slimmed-down *Vorstand* has watched over such tasks as strategy and risk management, while a new group executive committee runs the bank day to day. This week, when Deutsche unveiled so-so results for the first quarter of the year, it gave a further indication of the sort of business Mr Ackermann plans to run.

Through lower costs and fatter margins, the bank hopes to boost a market capitalisation about which Deutsche has long fretted. Nine years ago, it was worth more than any bank outside Japan. Now it is well down the league. Britain's HSBC has a stockmarket value almost three times Deutsche's *euro*44 billion ($40 billion), while America's Citigroup is more than five times as big. This week Mr Breuer told *Börsen-Zeitung* that the low share price was of “vital significance”. He thinks Deutsche is an improbable (though not unthinkable) takeover target. But Deutsche's shares are worth too little as an acquisition currency for it to make big deals of its own.

Deutsche's plans can be broken into three. First, it wants to cut non-interest costs by *euro*2 billion or more by the end of 2003. To achieve this, it will probably have to shed more jobs than the 9,200 so far made or planned. Although spending was lower in the first quarter than analysts expected, this reflects lower bonuses, which will surely pick up again when business revives. The bank's cost-income ratio is still close to 80%.

The second element is an acceleration of sales of shareholdings in other big German companies, worth about *euro*14 billion, and of private-equity investments. The main shareholdings include 12.9% of DaimlerChrysler, as well as slices of Allianz and Munich Re, Germany's two biggest insurers. Deutsche raised about *euro*1 billion in the first quarter, mainly from shares in Allianz and Munich Re, after the capital-gains tax on such sales was abolished at the start of the year. The bank plans to return money to shareholders, buying back up to 10% of its equity. So it is, in effect, swapping other firms' shares for its own, which it considers good value.

The third part is to make more money out of both business and private customers. Returns on corporate lending in Germany are paper-thin. Trying to raise them, though, is a delicate subject in a land where politicians utter the word *Mittelstand*—the country's small and medium-sized companies—with near-religious awe. So Deutsche says that it is committed to its “demanding German mid-cap clients”, but only “where a fair risk-adjusted return can be made.”

In other words, sorry, but some customers are not worth keeping. To some companies, at the top end of the *Mittelstand*, Deutsche's corporate bankers can expect to sell fancy products. The rest are to be bundled into the bank's private-client and asset-management division, which houses Deutsche Bank 24, the retail-banking arm (which already serves some small firms in any case), private banking (for richer customers) and Deutsche's online broker, called maxblue. All these activities will have a single management team. Their mother brand, Deutsche Bank, will have greater prominence.

The private-client and asset-management division as a whole will have to do more to pay its way. In the first quarter, its asset managers made a return of just 4% on equity; its private bankers made only 9%;

and its retail bankers made a loss. To improve matters, Deutsche has already bought Scudder and RREEF, two American firms of “active” asset managers. This promises higher returns than “passive” management—ie, index-tracking. Deutsche lacks scale in both the passive business and in custody, and it may sell these operations. It also plans to build up its strength in wealth management (for the truly, wickedly rich).

For years Deutsche's other wing, the investment bank and its traders, have brought in most of the money. Just over two years ago, Mr Breuer wanted to ditch retail banking after a planned merger with Dresdner Bank, also in Frankfurt. In February last year, with the merger aborted, all change: the private-client and asset-management side had a glowing future, growing faster than the investment bank up to 2003, and with twice the rate of return. The foundations, Mr Breuer may say, have been laid, though the results so far have been disappointing. Under Mr Ackermann, will the whole bank work at last?

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Bankruptcy in America

Debtors' bail

May 2nd 2002
From The Economist print edition

America's bankruptcy laws are about to get tighter for consumers

CREDIT cards have long been a source of fat profits in America, which has the lowest savings rate of any big country. Consumers' appetite for borrowing has allowed card issuers to charge interest rates way above the prime lending rate. Issuers say they need these high rates to make up for growing credit-card defaults. America's bankruptcy laws, after all, are famously liberal. A defaulter can file for bankruptcy easily enough, and discharge his debts. But that looks set to change. Card issuers give big political donations. Congress is on the verge of passing new laws to make it harder for even the hardest-luck cases to avoid paying for their sprees.

If the laws go through, issuers claim, interest rates on consumer loans might come down. Unlikely. The market for credit cards competes on everything but price. As a rule, credit-card rates are quick to rise along with the prime rate, but fall more slowly. When the Fed cut interest rates deeply last year, card issuers kept their rates steady and reaped billions. America's credit-card issuers have certainly tried to be inventive. They have created “affinity” cards festooned with the logos of customers' favourite teams and charities. They have made an art of direct marketing, stuffing postboxes across the land with new solicitations. These days, they give credit cards to almost anybody: lack of a job, or even of a bank account, is no obstacle.

The latest push to revise the law has been sparked by fears that former executives at Enron, the fallen energy giant, could in some states use bankruptcy to shield million-dollar mansions. Yet, says Elizabeth Warren of the Harvard Law School, loopholes in the current proposal mean that, in practice, executives liable for debts incurred as part of a business—and for tax reasons, many executives set up businesses through which they run their wealth—will be treated far less harshly than the consumer debts of, say, a former Enron mailroom worker.

America's lax attitude towards bankruptcy goes back to the country's earliest days. Many of its founding fathers were mired in debt. Today, Britain and other countries are liberalising bankruptcy laws with an eye to making their economies more dynamic—just as America is going the other way.

If this seems like a strange turn, chalk it up to the obsessions of America's lawmakers today. For example, the bankruptcy bill has most recently been delayed by a dispute to do with abortion politics. Democrats are fighting to make it as tough on anti-abortion activists facing fines for illegal protests as on their poorer constituents swamped by credit-card debt. Appeals to crude politics, and big donors, are not the best way to improve bankruptcy laws.

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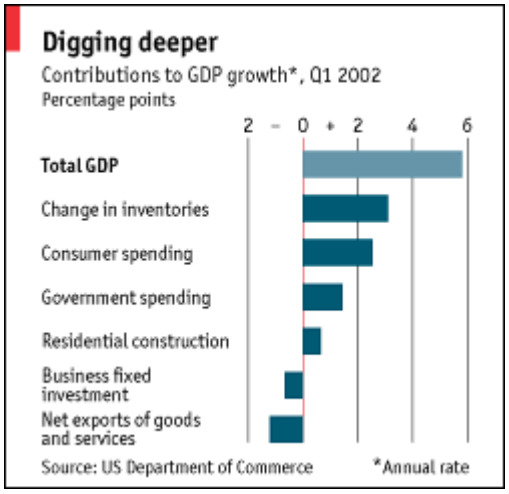
America's economy

A hard act to follow

May 2nd 2002
From The Economist print edition

Do not expect America's extraordinary growth to be sustained



ON THE face of it, America's economy is roaring back. In real terms, its GDP grew at an annual rate of 5.8% in the first quarter. It leaves the rest of the world far behind: Britain's economy grew by just 0.3% in the same quarter, while the pace for Japan and the euro area is reckoned to have been no more than 1-2%. America's numbers look almost too good to be true—which may be why they were followed by falls in share prices and the dollar.

Dig beneath the headline figure for growth and America's performance looks less miraculous. Almost four-fifths of the bounce in GDP came from firms reducing their inventories at a slower pace than in the previous quarter, and from a big jump in government spending. Defence spending grew at an annual rate of 20%. At the same time, residential construction, up an annualised 16%, was given a temporary boost by one of the mildest winters on record. Total final sales (which does not count changes in inventories) rose at an annual rate of only 2.6%, If one also strips out the jump in defence spending and, to take a rough guess, half of an unsustainable boom in construction, then growth falls to a mere 1.5%.

Consumer spending rose by a reasonable 3.5%, but fixed investment by firms fell, for the fifth consecutive quarter. Alan Greenspan, the chairman of the Federal Reserve, has said repeatedly that a pick-up in investment is critical for a sustained economic recovery. But that, in turn, requires stronger profits.

The new GDP numbers not only showed that growth is less robust than it seems, but that inflation is unusually weak. The GDP deflator—the amount by which nominal GDP is adjusted to take inflation into account—rose at an annual rate of only 0.8% in the first quarter, to give a year-on-year rise of 1.3%. It will probably fall further: in the past, the GDP deflator has fallen on average by more than one percentage point in the first year of a recovery, as productivity has rebounded faster than costs.

An unusually low rate of inflation, combined with uncertainties about the strength of the recovery, has two big implications. First, the Federal Reserve is unlikely to raise interest rates in the near future. It will not want to run the risk of allowing inflation to get too close to zero, where options for conducting monetary policy rapidly dwindle. Second, the lack of pricing power is likely to result in a weaker rebound in profits than in previous recoveries, dampening stockmarket hopes.

The S&P 500 index remains one-third below its 2000 peak. Uncertainty about profits is not the only factor that weighs on share prices. Lombard Street Research points to something else that may hold down equities: tighter liquidity. America's broad-money supply, measured by M3, has slowed sharply in the past three months. Usually, when the money supply grows faster than GDP, excess liquidity spills into financial markets—as happened late last year. When money-growth falls below GDP growth, liquidity tends to be drained out of markets, pushing down share prices. Were the stockmarket to slide further, strong consumer spending, the main driver of GDP growth in the first quarter, might come into question.

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Corporate governance in Poland

Minority protection

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Shareholder rights have been bruised by big investors

IT IS when the car starts to sputter that the driver questions the model. Poland's once stellar growth rate has now slumped to barely 1% a year. Unemployment, at 18%, is the second-highest in the OECD. In these testing times, managerial performance and accountability at Poland's listed companies has become a hot topic, with lots of ideas for improving the abysmal quality of corporate governance.

Warsaw's stock exchange, reopened 11 years ago, is now Central Europe's largest by volume. But it has never been a star performer. Many of the exchange's 230-odd listed companies are poorly run and pay scant attention to shareholder value.

Efforts to improve corporate governance come after a string of high-profile shareholder conflicts at listed firms. “Unfortunately,” says the long-time head of the Warsaw bourse, Wieslaw Rozlucki, “you need glaring cases to convince the public of the seriousness of the situation.” Some of the biggest criticism has fallen on foreign investors. Last year Michelin, France's tyre giant, angered minority investors when it would not open the books of its listed Polish subsidiary: investors said Michelin was squirrelling profits abroad. Minority shareholders in Bank Slaski chided its main investor, ING of the Netherlands, over the terms of a merger.

In the past, Poland lacked assertive minority investors. Yet pension funds in Poland are now managing their investments along more Anglo-Saxon—that is, more assertive—lines. The funds, which may invest up to 40% of their assets in domestic equities, head a campaign to strengthen and enforce shareholder rights. Pension funds have led the criticism of Michelin and ING, as well as of local moguls.

Polish officials say that conflicts stem from the dominance of large shareholders in listed companies, the result of a spate of privatisation tenders over the past decade in which many of the country's biggest companies were sold to western multinationals. As a consequence, Poland has a structure of ownership closer in its concentration to that of continental Europe than of America or Britain. Shareholder activists argue that this strengthens the case for far-reaching governance reforms.

In recent weeks two competing working groups, one in Warsaw, the other in Gdansk, have put the finishing touches to draft codes of best practice. They are designed to protect the interests of minority investors, improve the accountability of companies and maximise shareholder value. Like many codes within the European Union, the documents are non-binding sets of principles, though they require listed firms to disclose whether they abide by the codes or not—the so-called “comply or explain” approach. Non-compliance will carry a cost: a 15-30% discount in the share price, says Grzegorz Domanski, a partner at Andersen Legal (now part of Ernst & Young), who chairs the Warsaw group's best-practice committee.

Listed companies and their large shareholders do not welcome the proposed codes. A lawyer for minority shareholders in the Michelin case says that the French company refuses to talk about “shareholders” when confronted with governance issues, sticking instead with the mushier concept of “stakeholders”. Michelin is some stakeholder, with 65% of the local tyre maker.

Even some Polish fund managers say that the proposed codes must not antagonise big investors on the Warsaw bourse. “If corporate governance in Poland is seen as a threat to strategic investors, then we're all doomed,” says Pawel Wojciechowski, head of the Allianz pension fund in Warsaw. Not words that minority-rights campaigners like to hear.

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Gold in Japan

Jitterbugs

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Ordinary folk in search of a safe haven

WAY back in 1989, when Japan was still flush with money, the government tossed the country's 3,000-odd towns and villages ¥100m ($770,000) apiece. Nakatosa-cho, a fishing port in Shikoku, an island in south-west Japan, spent its windfall on a solid gold bonito, weighing 52 kilos (it was stolen the following year). More than a decade later, the Japanese are stocking up on gold once again, albeit under very different circumstances.

In the first quarter of this year gold imports rose almost sixfold over a year earlier, to some 41,000 kilos. Customers, says Tadashi Kizu, marketing manager at Ishifuku Metal, the third-largest dealer in precious metals, are coming in with wads of cash and walking out with gold bars. Gold futures are also doing brisk business. Trading volumes so far this year are three times greater than they were last year.

Gold has become a safe haven for investors who are concerned about Japan's wobbly financial institutions and economy. Investors dislike equities, which have fallen steadily for at least a decade. They worry that the country's rising national debt might eventually cause a fall in the value of government bonds. They are uneasy about putting money into foreign-denominated assets, after suffering from volatile currency swings in the past. And, to top it all, says Itsuo Toshima, regional director at the World Gold Council, some of today's buyers of gold also had their fingers burnt when they put savings into money-market funds with such safe investments as the paper of Enron, Argentina and Mycal, a supermarket chain that went bust last September.

The biggest reason, however, for the latest rush to gold, is the lifting of the government's blanket protection of bank deposits on April 1st, leaving savings accounts of over ¥10m unprotected. Depositors used to be reluctant to invest in commodities such as gold, because they yielded no interest. But now that big banks have lowered interest rates on deposits to 0.001%, depositors often pay more in transaction fees than they earn in interest.

These days banks themselves are selling gold to depositors who have lost faith in them in other respects. Takeo Umezawa, president of Sumisho Materials, a gold wholesaler, says that demand from financial institutions has been on the rise. Banks can earn 1% in commissions on gold sales, more than they make on their lending.

Japanese investors have traditionally turned to gold in times of trouble. Gold imports rose in 1997 when Yamaichi Securities, then the country's fourth-largest brokerage, collapsed, and again later when two big banks went under. Since few believe that Japan's financial woes are over, expect more gold sales in the coming months.

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Economics focus

A voice for the poor

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As Friedrich Hayek was to socialism, Peter Bauer is to foreign aid

AS SOCIALISM and central planning gave way to resurgent market forces in the second half of the 20th century, three great economists were brought in from the ideological wilderness. Friedrich Hayek, who in 1944 predicted the demise of command economies in “The Road to Serfdom”, was later to inspire the free-market policies of Ronald Reagan and Margaret Thatcher. He also inspired Milton Friedman, a fierce advocate of free markets and monetarism at a time when Keynesian demand management was the order of the day. And now Mr Friedman has given his name to a new biennial prize “for the advancement of liberty”, which will be awarded on May 9th to the least famous of the three, Peter Bauer.

Born in Budapest in 1915, the young Mr Bauer came to Britain in 1934, taught at Cambridge and the London School of Economics, and was made a peer in 1982. Lord Bauer's work applies classical economics to questions of poverty and development, where conventional wisdom, for 30 years after 1945, was remorselessly hostile to market solutions.

After the second world war, a new “development economics” came to dominate policymaking in poorer countries, often at the urging of international institutions such as the World Bank. It argued that poor countries were victims of a vicious circle of poverty, doomed to remain poor because they lacked the income that provided savings which, when invested, generated economic growth. The answer? Rich countries should provide the capital, in the form of foreign aid. To use the capital efficiently, poor-country governments should plan their economies and create new industries to substitute for foreign imports. And to give these nascent industries a chance, competition should be restricted through monopoly rights and barriers to foreign trade.

Both the theory and its practice appalled Lord Bauer. His studies of smallholdings in the Malaysian rubber industry and of the importance of small-scale traders in West Africa had convinced him that there could be wealth creation, even in subsistence economies, if only market forces were allowed to work. Trade barriers and monopolies merely destroyed entrepreneurialism.

In his blunt way, Lord Bauer set out alternative theories that, from the 1950s to the 1970s, were heresy. All countries had started poor, he argued. If the vicious-circle theory were true, mankind would still be living in the stone age. Opportunities for private profit, not government plans, held the key to development. Governments had the limited though crucial role of protecting property rights, enforcing contracts, treating everybody equally before the law, minimising inflation and keeping taxes low. It was a tragedy that countries neglected this role.

Above all, Lord Bauer argued, there would be no concept of the third world at all were it not for the invention of foreign aid. Aid politicised economies, directing money into the hands of governments rather than towards profitable business. Interest groups then fought to control this money rather than engage in productive activity. Aid increased the patronage and power of the recipient governments, which often pursued policies that stifled entrepreneurship and market forces. Indeed, aid had proved “an excellent method for transferring money from poor people in rich countries to rich people in poor countries.”

Above all, Lord Bauer argued, there would be no concept of the third world at all were it not for the invention of foreign aid

Why so much aid, then? Western post-colonial guilt, Lord Bauer claimed, before debunking the notion that countries are poor because they were exploited by former colonialists. They are generally better off now than they were before colonialism. The most developed of the poorer countries are those that have the most interaction with rich countries, through

trade and the exchange of ideas.

Today, many of Lord Bauer's views on aid and development are part of a new conventional wisdom. Even the World Bank admits that creating the right conditions for markets to flourish is the key to economic development, and that until recently much of the money that it has supplied has been badly used. Lord Bauer is not convinced that he has won, though, for government-to-government aid has increased, not decreased. Even though there is now more public questioning of aid, he is not optimistic about further change. There are so many vested interests behind foreign aid, “regardless of its effects”.

Some of his other views remain out of the mainstream, at least for now. Lord Bauer opposes policies aimed at reducing income inequality. This is not because he favours inequality—although he thinks it often reflects fair pay for output produced—but because policies designed to promote equality usually infringe personal liberties to such an extent as to slow economic development. If, as often happens, development happens to reduce inequality, then so much the better.

Nor does Lord Bauer favour population control. Worries about population growth, he says, reflect a patronising view that the poor are incapable of making sensible choices about having children. The much deplored population explosion “should be seen as a blessing rather than a disaster, because it stems from a fall in mortality, a *prima facie* improvement in people's welfare.” At the same time, he argues, there is no correlation between population growth (or even density) and poverty. The population of the western world has more than quadrupled since the mid-18th century, yet real income per head has increased at least fivefold.

In short, economic development rests on people having the right desires and aptitudes, and on a political and legal system that allows people to act on them. In this, the poor are no different from anybody else. Formerly heretical insights such as these put Lord Bauer in a class of his own as an economist, says Amartya Sen, a darling of the aid and development world and both a former student and a sparring partner of Lord Bauer's. His blunt lack of political correctness may have prevented Lord Bauer from sharing the Nobel prize awarded to Mr Sen in 1998. The Milton Friedman prize should provide some consolation—not to mention $500,000.

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Psychology

Persuasion

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From The Economist print edition

Scientists are uncovering ways of making messages more persuasive. Politicians and salesmen use such tricks already. Who can afford not to read on?

AKG

YOUR correspondent was not sure whether to write this piece. But Eric Knowles, a professor of social psychology at the University of Arkansas, was very convincing. He said that he had experimental evidence to support a new approach to persuasion—one that works on removing people's inhibitions, or lowering their resistance.

Dr Knowles is so compelling that he has managed to persuade America's National Science Foundation to give him $163,000 to find ways of making messages and appeals more persuasive. Recently, he and a number of other researchers outlined their work on resistance-reduction at a meeting at the University of Arkansas.

Resistance is useless

When somebody is torn over a decision, some aspects will be attractive and encourage acceptance; others will be displeasing and create resistance. Researchers refer to persuasive strategies that work by making an offer more attractive as “alpha” strategies. Those that work by minimising resistance to the offer are called “omega” strategies. Dr Knowles operates at the omega end of the alphabet.

His main insight into omega strategies is the idea that resistance is in some sense a thing, and that it can thus be used up and replenished, rather like water in a tank. Such changes in resistance level are not necessarily the result of logical or rational argument. Once the level drops, the tank is topped up gradually until it is full again, rather as a water-closet cistern refills itself after it has been flushed. The task of the persuader is to drain the tank. That of the consumer is to keep it full enough to resist undesirable changes.

Resistance is in some sense a thing and can thus be used up and replenished, says Dr Knowles

In collaboration with Jay Linn, a colleague at Arkansas, Dr Knowles recently set out to test this idea in the context of political advertising. First, the two researchers asked a few questions which they used to divide their subjects into groups that might be described (although they did not use such terms themselves) as “sceptical” and “gullible”. They then redivided them into four groups and subjected each group to a different experimental “treatment” that involved watching a series of seven video-clips showing unfamiliar candidates for office talking about where they stood on a particular issue.

One group was asked to pay special attention to the first clip; the other three had to concentrate on the last. Two of the latter three groups were also shown a short travelogue about Fiji before the final clip. One of those two groups was asked to think positively about Fiji, and the other was instructed to make a list of all the things that could go wrong on a trip to the islands. Finally, all the subjects had to criticise each advertisement and candidate.

“Gullible” subjects used up their resistance to the advertising early on. They became less and less critical

of both the policies and the candidates as the experiment proceeded. Since the clips were shown in different orders to different subjects, that could not be due to some inherent lack of worth in the message or the messenger. Subjects' reactions to the final clip depended on the approach that they had been asked to take to the travelogue. They showed greater dislike of the final candidate when allowed to "replenish" their resistance by watching it in a positive frame of mind than if they had been asked to worry about the trip's difficulties. This result fits well with Dr Knowles's model.

"Sceptics" behaved differently. They were least critical of the initial candidate, but became increasingly negative as the advertisements progressed—no matter how they were asked to view the Fiji tape. In this case, repetition seemed to build up resistance, rather than draining it. Fitting that result into Dr Knowles's model is harder. To pursue the cistern analogy, it suggests that the ballcock which detects water level is being moved upwards. The idea of resistance as a variable quantity is still there, but the relationship between its initial level and its tendency to rise or fall from that level needs further investigation.

Je ne regrette rien

Another powerful part of decision-making is anticipated feelings of regret. This is why people are, for example, reluctant to trade lottery tickets—they think about how awful they would feel if their numbers came up. Addressing such fears directly can be a way of increasing or reducing resistance, and is thus another example of an omega strategy.

Steven Sherman, a researcher at Indiana University, and his colleagues, recently demonstrated the effects of anticipated regret by offering two groups of participants in an experiment a choice between two trivial and, on the face of it, equally attractive alternatives: which of two football teams to place a bet on. A "ringer" planted among the subjects by the experimenters pushed them to choose one team rather than the other. One group was also asked, using a questionnaire, to consider how much regret they would feel if they did not take the proffered advice. Those in this group were much more likely to choose what had been recommended than those in the first group. That result gives marketers a powerful fear to play on.

There are other tricks that can be employed to lower resistance. It can, for example, be "disrupted" by the unexpected. In an experiment a few years ago, students posing as beggars found that they received small change 44% of the time that they asked directly for it without specifying a sum. If they asked for a precise sum that was a single coin (25 cents), they got it 64% of the time. But if they asked for an apparently arbitrary number (37 cents) they got it 75% of the time. The more precise and unusual the request, the less people were able to resist it.

We have control

All this talk of resistance is, of course, rather fuzzy—though it is still of great interest to advertisers and salesmen. But Dr Knowles thinks that alpha and omega strategies may be more than mere phrases. They may correspond to the separate neurological systems that animals have for behavioural activation and inhibition. According to this model, omega strategies work by reducing inhibitions to action.

This suggests that the resistance mechanism is "hard-wired" into the developing brain. But researchers such as Brad Sagarin, a psychologist at Northern Illinois University, think that levels of resistance can, to some extent, be learnt—and that they can be built up by exercise. In other words, the tank itself is capable of either temporary or permanent enlargement, in response to circumstances and experience.

Is resistance "hard-wired" into the developing brain, or can it also be learnt?

For example, people often do not resist advertising, because they have the illusion of invulnerability to its effects. They believe that advertising is something that only affects everybody else. But, says Dr Sagarin, if you demonstrate to somebody that this is not true by showing them that they have been fooled, this causes a powerful increase in resistance.

People want to avoid being duped or cheated. Indeed, results from evolutionary psychology, a discipline that tries to elucidate the origins as well as the nature of human emotions, suggest that detecting and avoiding cheats is one of the strongest driving forces of human psychology. That supports the idea that

the resistance mechanism has been wired in by evolution.

Whether the world really needs to know more about making messages more persuasive is a different question. Needless to say, all the researchers are convincing on the subject. It is true, as Dr Knowles admits, that such knowledge can be used coercively. But he points out that it can also be used to educate. In any case, he says, “By minimising a person's resistance, you'll decrease the chance that they'll experience future regrets about the decision.” Not convinced about the science of persuasion? Readers are asked to consider how regretful they may feel if they later conclude that it was right all along.

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Human sexual behaviour

Playing away

May 2nd 2002
From The Economist print edition

Women are most attracted by infidelity when most susceptible to impregnation

IT IS easy to understand why men are unfaithful. A man's reproductive output, like that of a male of any species, is limited mainly by the number of females he can impregnate. For women, the explanation of infidelity is more subtle. Women need (in evolutionary terms, as well as in everyday life) quality in partners, rather than quantity. And however admirable their main squeeze might be, it is unlikely that his genes are unbeatable. They may also need variety. If different children have different fathers and therefore different genes, the vicissitudes of life are less likely to carry away the whole brood in one go. Both of these needs mean that even women in stable relationships may not be above the occasional act of adultery.

Adultery, however, carries a price. Even in societies that have stopped stoning people for it, it can lead to desertion. Few men wish to expend their efforts raising another man's children. Natural selection should therefore have furnished both sides in this arms race with suitable weapons for getting their own way. Women would be expected to have adulterous desires most often when those desires are most likely to result in a successful outcome (ie, pregnancy). Men would be expected to show most caution against such risks when they are greatest. And that is just what Steven Gangestad, Randy Thornhill and Christine Garver, of the University of New Mexico, have found.

Previous work has shown that women are more sexually aware around the time of ovulation (for example, dressing in ways that reveal more skin). Dr Gangestad and his colleagues wondered whether this was a general heightening of response, to enhance the chances of conception all round; or whether it might be directed particularly towards men other than the one described so unromantically in the jargon as the “primary partner”, to enhance the chance of a successful adulterous liaison. They also wondered what, if such a wandering of attention did occur, the primary partner's response to it would be.

Working in a university, the researchers had a ready supply of female students willing to act as subjects. They chose 51, of whom 31 said they had primary partners. The subjects' hormone levels were monitored to detect when they had ovulated, and they were asked to fill in questionnaires twice: once when they were fertile, and once when infertile.

The questions concerned both their own behaviour and that of any primary partner. Questions about their own behaviour involved their attraction to, and fantasies about, their primary partners, and to and about other men. Questions about their partners' behaviours asked about signs of “proprietariness” and “attentiveness”. Proprietariness included vigilance (unexpected telephone calls to check whereabouts; looking through personal belongings) and getting angry if the woman was seen alone with another man. Attentiveness included spoiling (gifts, meals out and so on) and monopolisation (spending as much time as possible with the woman).

The results, just published in the *Proceedings of the Royal Society*, suggest that natural selection has not, indeed, been idle in this area. As expected, the women in the study showed a big increase in attraction to, and fantasies about, other men when they were fertile. That increase did not, however, extend to primary partners: their attractiveness changed only marginally over the cycle. It is not the case, therefore, that women simply feel more sexy when they are fertile. That sexiness is directed specifically towards infidelity.

Primary partners, on the other hand, seemed acutely (though possibly unconsciously) aware of what was going on—at least the women in the study perceived they did. Both proprietariness and attentiveness were reported as going up significantly during a woman's fertile period.

There is a risk, of course, that this result is due to reporting bias. Women may notice such “mate guarding” more when they are fertile because it is then more onerous. But it is just as likely that selection has furnished men with sensibilities that allow them to switch their efforts, as need dictates, to fending off external interest in their partners. How much those efforts are otherwise directed towards finding outlets for their own adulterous desires remains to be investigated.

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Neuroscience

The brain-in-a-rat problem

May 2nd 2002
From The Economist print edition

Nefarious neuroscientists compel rats to do their evil bidding

IMAGINE robots that can scale stairs, climb walls and jump off trees. Not only can they fuel themselves and clean themselves; they can reproduce themselves to boot. It takes about ten minutes a day, for about ten days, to make one. Most of the hardware is available off-the-shelf, and the total bill comes to about $50. Oh, and one more thing: they're alive.

The “robots” in question are really rats with electrodes implanted into their brains to tell them what to do. An operator sitting at a laptop computer can control the movement of the rats via a transmitter that activates the electrodes. Up to a point, a “roborat” will do whatever its operator instructs—even things that are instinctively repellent to it, such as hanging around in brightly-lit open spaces.

Although the idea sounds shocking, the principle behind the experiment is not new. Three years ago, John Chapin, Sanjiv Talwar and their colleagues at the State University of New York, in Brooklyn, developed a “neural interface” that allowed an animal to manipulate a robotic arm simply by thinking about it. An implant would record the signature of the electrical firing of the subject's nerve cells and relay the information to the arm. Their latest experiment, described in this week's *Nature*, simply reverses this process. Rather than extracting information from the firing of nerve cells, the new system feeds stimulation to certain cells in a rat's brain in a pattern that coaxes it to move as desired.

The trick lies in getting the right nerve cells to fire at the right time. The researchers trained a rat to move by stimulating part of the brain known as the somato-sensory cortex (this is the region responsible for bodily sensation). When electrodes stimulate a certain patch of this cortex, a rat feels a nudge on its left whiskers. When another patch is stimulated, the nudge is to the right whiskers.

Since rats rely on signals from their whiskers to detect obstacles, Dr Talwar and Dr Chapin were able to use the electrodes to persuade a rat to move one way or the other. To reinforce their false signals, they also sent pulses to a part of the brain known as the medial forebrain bundle (MFB) whenever a rat obeyed. The MFB is the so-called “pleasure pathway” that is thought to be responsible for both the sense of motivation and the sense of reward. Rats worked out that obeying the nudges would produce pleasurable feelings, and quickly fell into line.

Despite appearances, Dr Talwar says that his rats are “not zombies”. They retain their native intelligence and when guided towards an obvious threat or a difficult obstacle, they flinch and recoil. With enough MFB stimulation, this hesitation can sometimes be overcome, but occasionally cannot. Of course, he admits, the experimenters never actually tried very hard to push a rat to do something self-destructive or uncomfortable. So the strength of a rat's willpower remains untested.

So, too, does the limit of a human's. In all probability, a similar device could be installed in a human being tomorrow, though Dr Talwar thinks it should be illegal to do so. Whether anybody else will want to have a go—and whether any ethics committee would allow them to try—remains to be seen.

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Fly-by-fibre

Safer choppers?

May 2nd 2002 | MUNICH
From The Economist print edition

How to solve helicopters' problems with electromagnetic interference

THE death on April 28th of Alexander Lebed, a Russian general and politician, when the helicopter he was travelling in apparently hit power lines in poor visibility, underlines how vulnerable such machines can be. Even when they do not collide with cables, low-flying helicopters run the risk of their controls being disrupted by electromagnetic interference (EMI) that emanates from them. This problem (which can bring down even fixed-wing aircraft; it caused the crash of a Tornado fighter jet in Europe some years ago) is likely to get worse as helicopters' systems become more electronic and less mechanical, a development known as “fly-by-wire”.

Fly-by-wire offers two advantages. First, weight is saved as heavy hydraulic lines, cables and rods are replaced by computers that send electrical signals to actuators which adjust an aircraft's flight controls. Second, handling can be improved by relieving the pilot of many routine flight-control tasks, so that he can concentrate on the unexpected.

This benefit is particularly attractive for helicopters because, although fighter pilots look down on their chopper-flying colleagues, helicopters are actually quite difficult to handle. Their rotor blades are both their source of lift and their source of propulsion, which means a pilot is constantly having to compromise between the two. They also have a tendency to spin in the opposite direction to the blades, which has to be countered by the stabilising rotor on the tail-fin.

That is why fly-by-wire should be a godsend to helicopter pilots. Eurocopter, a firm that is part of the European Aeronautic Defence and Space Company, is duly fitting it. But there is still the problem of EMI. Eurocopter's more creative minds think that the solution to this may be to bypass wires altogether, and leapfrog from hydraulics to optical-fibre controls. Instead of fly-by-wire, fly-by-fibre. The principle is the same; the difference is that the signal is carried by an undisruptable laser beam rather than an easily disrupted electrical impulse.

The world's first such helicopter, an adapted EC135, made its maiden flight earlier this year. It was ordered by the German defence ministry to demonstrate how the new technology could work and to see whether it is worth developing for widespread application. It hasn't crashed yet.

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About sponsorship

Refugees and culture

Packing their talent

May 2nd 2002
From The Economist print edition

Exiles from Nazism brought America and Britain something of inestimable value

ONE spring morning in 1933, Max Ophuls, a celebrated film and stage director, arrived at his theatre in Berlin to find an underfed young man in a raincoat waiting impatiently for him in his office. He was the theatre's new manager, a Nazi. Ophuls, a Saarland Jew born Max Oppenheim, went at once to call his wife. “Pack,” he said. Two days later, they were in Paris.

Safe but penniless, Ophuls walked the streets wondering what to do. He knew no one. A man approached handing out fliers for a small, little-known cinema. “Have you seen ‘Liebelei',” he asked, “the new film by the great German director, Max Ophuls?” Ophuls went at once to where his film was showing and introduced himself to the manager—who moonlighted as producer and critic. So was launched a second brilliant career in France. It ran till 1940, when the Nazis arrived again and Ophuls had to decamp for Hollywood.

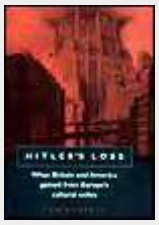
This refugee tale of narrow escapes, lucky breaks, recognition and new insecurities is typical of the exiles from the world of art and science who fled Nazism. They were fortunate in a way to carry their working capital in their heads. Many, though not all, were Jewish, and anti-Semitism was by no means the only hatred that drove them out. As Thomas Mann, a gentile, remarked of the books that joined the flames on Opernplatz, the Nazis were burning the works they couldn't write.

The Hitler exiles make a glittering honour roll: Adorno, Bartok, Brecht, Busch, Einstein, Freud, Gödel, Gropius, Gombrich, Hayek, Kleiber, Mann, Perutz, Popper, Schoenberg, Schwitters, Walter...the list could go on. Less often dwelt on perhaps than the remarkable individual stories of these men is their collective impact on the countries they went to.

Two new books address this question. Both brim with vivid sketches and good anecdotes. Tom Ambrose's book gains from covering America as well as Britain. Thanks partly to its narrower focus, Daniel Snowman's keeps a firmer eye on the main issue. The economic benefits of immigration are widely known. But it is good here to be reminded of the cultural ones. As Walter Cook, the director of New York's Institute of Fine Arts, liked to say of his sought-after refugee scholars, “The Nazis shake the tree, and I collect the fruit.”

A risk with all cultural history is to overdo place (ideas travel) and underplay continuities (American universities were already Germanic in structure and till the first world war a German press and culture flourished in many big cities). Looking for political patterns is also fraught: the once-canvassed claim, for example, that right-wing refugees were drawn to

Hitler's Loss: What Britain and America Gained from Europe's Cultural Exiles
By Tom Ambrose



Peter Owen; 232 pages; $34.95 and £17.95

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The Hitler Emigrés: The Cultural Impact on Britain of Refugees from Nazism
By Daniel Snowman

Chatto & Windus; 466 pages; £20

Buy it at
Amazon.co.uk

conservative Britain, radical ones to a forward-looking United States now seems schematic, if not false on the facts.

The Hitler refugees made an impact nevertheless, especially in Britain, which was smaller and culturally more compact. Many found the country smug and provincial—and this cannot be brushed off as a reaction to wartime internment as enemy aliens. Institution by institution, Mr Snowman shows how emigrés opened up British high culture to European modernism. He notes in particular their beneficial influence in music and publishing.

Was their impact more than the sum of distinct contributions in their many métiers? Yes and no. Both books avoid the vulgar mistake of treating modern thought in Austria and Germany early last century as peculiarly Jewish. That idea, as Ernst Gombrich, a great art historian, memorably put it, was an invention of Hitler's forerunners and after-runners.

No, the emigrés were children of reason and the enlightenment—even if some denied it—and what intellectually they shared with their new countrymen was greater than any differences. Yet they were not Oxbridge dons or Ivy League professors. They had their own style, their own memories, their own jokes and their own household gods. They contributed, in sum, to that vital element, diversity. This was not always recognised at the time. Is it adequately recognised of today's immigrants and refugees?

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By Tom Ambrose.
Peter Owen; 232 pages; $34.95 and £17.95

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About sponsorship

Musical lives

Knowing the score

May 2nd 2002
From The Economist print edition

FROM 1892, when he conducted the world premiere of Leoncavallo's “Pagliacci”, until 1931, when Mussolini's fascist government withdrew his passport and forbade his performances, Arturo Toscanini (1867-1957) was the most renowned Italian conductor of the age. This is the first collection of his letters, and, ample though it is, it represents only a small proportion of the huge number of letters that Toscanini wrote in a long life.

The recipients include Giacomo Puccini (Toscanini conducted the premieres of “La Bohème” and “Turandot”), Richard Strauss, and Debussy, though devotees of Toscanini may be more intrigued by some of the love letters written later in his life to several lady friends. Despite his pre-eminence as a conductor, Toscanini was not infallible on musical matters. He dismissed Mahler in 1905 as “not a genuine artist”, calling him “commonplace and trivial”. Stravinsky, however, believed that it was Toscanini's performance of “Petrushka” in Rome in 1915 that marked the turning point in his composing career.

The Letters of Arturo Toscanini
Edited by Harvey Sachs

Knopf; 528 pages; $35.
Faber & Faber; £30

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Toscanini's fame today rests largely on the recordings he made in the United States with the NBC Symphony Orchestra in the 1940s. This special relationship with this American orchestra—of which Toscanini was principal conductor for 17 years—would probably not have come about had it not been for the political turmoil in Europe in the early 1930s. Once Hitler had gained power in Germany in 1933, Toscanini never conducted there again. Before that, though, in 1931, he had been attacked by a fascist group in Bologna: they assaulted him at a concert and then stood in a mob outside his hotel making threatening gestures. The letters surrounding the ensuing controversy, which eventually led to Toscanini's permanent departure from Italy, form the most absorbing section of the main part of the book.

Like many artists, Toscanini had remained somewhat aloof from politics, but he was alert to the threat of Nazism, and eventually forced to recognise the hopeless situation in Italy, so long as the fascists were in power. “Cursed Rome, Mussolini, the Emperor-King, and the Pope. Pigs all of them”, he wrote after the Italian invasion of Ethiopia in 1935.

The letters read well in English, and there are many annotations and footnotes. As their editor, Harvey Sachs, alerts us, more material is waiting to emerge. But we have here plenty enough already to reveal Toscanini as an artist full of doubts and questions—and as someone also of considerable perception in emotional and psychological matters. He had enormous pride, Mr Sachs tells us, but also a strong distaste for anything that smacked of servility or opportunism.

The Letters of Arturo Toscanini.
Compiled, edited and translated by Harvey Sachs.
Knopf; 528 pages; $35.
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About sponsorship

New films from Asia

Asian babe

May 2nd 2002 | UDINE
From The Economist print edition

Sex, stars and small pigs

THE strongest films at the fourth festival of Asian cinema at Udine last month were the eight pictures from China. Many were by young directors, younger even than the so-called fifth generation that put Chinese movies on the map in the 1980s. But Huang Jianxin, a veteran director who made “The Black Cannon Incident” (1985), showed that he could still teach the newcomers a shot or two.

In his latest film, “The Marriage Certificate”, a do-good employer promises a new blanket to couples who can prove that they have been married for 18 years. A psychiatrist and his wife would qualify if only they could find their marriage certificate.

Could they not procure a duplicate? Not so easy in China. The law says the certificate must come from the original issuing office. But theirs has long been disbanded, merged with a dozen others and all records lost. The frustration puts such strain on the marriage that divorce looms. There is only one problem: no couple may divorce unless they can prove they were legally married. Huang Jianxin still makes China's wittiest bureaucratic lampoons, undercutting any potential sentimentality with a sharp running commentary from the couple's no-nonsense daughter.

The best of a number of strong South Korean films was a historical epic called “Musa” (“The Warrior”), set in 14th-century China shortly after the Ming dynasty came to power. Relations between Korea and China have been soured by the murder of a Ming envoy to Korea and a group of exiled Koreans hope to restore ties between the two countries by returning to her native land a Chinese princess they have rescued in the desert.

Kim Sung Su, the director, has a taste for violent action sequences and sweeping widescreen camerawork, but he has also taken unusual care to explore the characters of the Korean officers and NCOs and highlight their different reactions to a risky and controversial diplomatic strategy. The film benefits from a star performance as the Ming princess by a Chinese actress, Zhang Ziyi, now widely known in the West for her acrobatic work as the martial-arts queen in “Crouching Tiger, Hidden Dragon”. While she is more sedate here, her haughty oriental beauty suggests that many doughty warriors would consider the world well lost for her.

The film that tickled most viewers' fancy in Udine was a Hong Kong cartoon called “My Life as McDull”. McDull is a piglet whose mother had planned to call him McNificent until second thoughts prevailed. She still has high hopes for him, though, especially as a sportsman, and writes to the president of the international Olympic committee, urging the IOC to accept a new discipline at which McDull excels—bun-snatching. A traditional yearly event on Hong Kong's Cheung Chau island, with buns piled high and the winner the climber who could snatch the one at the top, bun-snatching has some pedigree. But the practice is banned when the pile collapses, injuring many competitors, and McDull never gets to demonstrate his Olympic prowess.

“My Life as McDull” uses a wide range of animation techniques—the two-dimensional style familiar from “South Park”, mobile pencil drawings, computer-generated effects and moments of live action. The film's appeal lies in its reflection of a child's view of the world, filtered through the more sophisticated eyes of adults. For a cartoon, the characterisation is unusually strong. McDull himself is a pug-nosed little porker with a big brown eye, a feature inherited from his mother, and he sounds rather like a Cantonese version of Babe, the movie pig who thought he was a sheep-dog. Born out of a popular Hong Kong comic strip, McDull may be about to become as well known as the horrible Eric Cartman.

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About sponsorship

History of Iraq

Putting Humpty together again

May 2nd 2002
From The Economist print edition

HOWEVER slow the motion, and however loud the voices of disapproval, the United States has made it clear that it is moving unstoppably towards a regime-changing assault on Iraq. Such an enterprise, suggests Sandra Mackey, an American journalist who has been covering the Middle East for some years, could turn out to be relatively easy in military terms. The political and economic consequences, not least for the United States, are another matter. If in removing Saddam Hussein, Iraq's central authority is smashed, this large and important country could be an extraordinarily difficult egg to put together again.

“The Reckoning” expounds Ms Mackey's thesis about the breakability of Iraq. She argues that the country's modern history of colonialism, military coups, a brutal police state and strangling sanctions have so exacerbated its ethnic, sectarian and tribal divisions that they have, in effect, extinguished any real sense of national identity. The United States, she writes, “is in danger of stumbling into the internal conflicts of another people, only to become trapped in old feuds it never comprehended.”

The Reckoning: Iraq and the Legacy of Saddam Hussein
By Sandra Mackey

Norton; 416 pages; $27.95 and £22.95

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Ms Mackey cannot be written off as a softie. She fully accepts American-British claims about the dangers posed by an Iraq that possesses chemical and biological agents and has nuclear potential. She agrees also with their argument that Mr Hussein himself is responsible for his people's economic deprivation and malnutrition. It is the problems of nation-building after the regime has been changed that concern her.

Her potted history ranges over the Iraqi people's misfortunes: neglect under the Ottomans, misguided British colonialism, failed monarchies, and the swift succession of military regimes that followed. The story comes to life in the 1970s, with her description of the Iraqi Baath Party, originally little more than a cadre of underground cells, seizing control of the state apparatus, with dreaded security services reaching into every corner of government and society. It eliminated the army from politics, dismissed the majority Shia Muslims into rural obscurity, and elevated a political tribe of Sunni Muslims to supreme authority,

Then there was Saddam Hussein, at first the strongman in the background of the Baath movement but, from 1979 onwards, taking over openly as Iraq's despot. He is, she argues, above all a tribal leader, his power based on a complex network of kinship from Tikrit in central Iraq. What exists in Iraq today, she writes, “is a tribal society in which the top echelon of the state is composed of Saddam Hussein's relatives and allies.”

A tribal Arab elite living on the fat of the land, the northern Kurds enjoying a quarrelsome semi-autonomous freedom that frightens Iraq's neighbours, and the rest of the country crushed by sanctions, the shredded infrastructure and Saddam's policemen. Is rebuilding this lot a challenge that a victorious America would be prepared to undertake? As Ms Mackey points out, Iraq is not in some corner of the world but at the centre of America's strategic interests. Its collapse into vengeful anarchy would be catastrophic.

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By Sandra Mackey.
Norton; 416 pages; $27.95 and £22.95

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About sponsorship

New American short stories

Walking tall

May 2nd 2002
From The Economist print edition

HENRY JAMES'S Americans in Europe were innocents in an old world incomprehensibly dark and complex. By contrast, Andrea Lee's transplanted Yanks seem more sophisticated than their beguiling but rather sidelined European cousins. Having hung their hats largely in Italy, where the author now lives, Ms Lee's "Interesting Women" have few illusions even about their own expatriation, for they are "smart enough to understand that the more energetically one sets oneself to master all kinds of idiom in a foreign country, the sooner one uncovers the bare, incontrovertible fact that one is foreign." The restive adventurers in these short stories are bound to later regard their continental years as merely a phase, as if Europe for Americans has become a place less to grow into than to grow out of.

One American wife demonstrates her fluency with loose continental mores by giving her Italian husband an evening with two call girls for his birthday, another her command of more primitive conventions in Madagascar when on holiday she slaps two flirtatious girls to keep them away from her French husband. Displaying the worldliness of the modern extended family, an American in Turin hosts another ex-wife of a man they have both divorced. Lending Ms Lee's expats an extra contemporary edge, most of these sleek, well-travelled women are black.

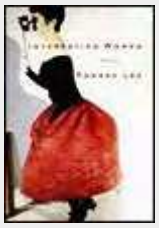
Indeed, so many of the main characters in these stories are well off, well educated, well dressed and dazzlingly attractive Americans who have married Europeans, live in Italy, and have one daughter, that a better title for this collection might be "Interesting Woman". But the allure of Europe's café society is well drawn, as is the subtle desolation of the everywhere-and-nowhere internationalist who has embraced the whole world at the expense of a smaller, more rooted one we more comfortably inhabit (or think we would if we could). Though she has strong, if unarticulated, views about national types, Ms Lee's prose is as clear-headed as her characters, who make great leaps between oceans and men only to "ponder the wonderful seductiveness of action, of clean defiant acts; and the tedium of consequences".

Like "Interesting Women", Michael Malone's "Red Clay, Blue Cadillac" exhibits a powerful sense of place, though this collection's floozies, murderers and temptresses are indigenous to its setting, the American South. Though Dixieland is well-trodden fictional territory, Mr Malone himself lives in North Carolina: his drawling dialogue comes naturally, and there's an easy, seductive sway to the prose as well. While Ms Lee's characters talk mainly about boyfriends and ex-husbands, their most intense relationships are with other women, and their cool intimacies may most entice female readers. By contrast, the boy-girl stories in "Red Clay, Blue Cadillac" are sure to appeal to men.

Mr Malone often views his eccentric belles through the desirous eyes of menfolk. A boy replicates his father's chivalrous crush on an ageing local film star, even though the father's loyal insistence that the star didn't really kill her husband proves unfounded. Persuaded by a beauty that her baby-blue convertible was a present to her mother from Elvis Presley, a salesman loses both Thanksgiving dinner and his wallet. In fact, most men in these stories end up scammed, abandoned or dead, but are usually so smitten beforehand that they might not have wished another fate.

Mr Malone's characters have a range and variety that Ms Lee's lack, and he's a born story-teller, reliably

Interesting Women: Stories
By Andrea Lee



Random House; 288 pages; $22.95.
Fourth Estate; £9.99

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Red Clay, Blue Cadillac: Stories of Twelve Southern Women
By Michael Malone

Sourcebooks; 294 pages; $15.00

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Amazon.co.uk

entertaining and wry. For example, in the town where Helen Keller was born, a neighbour tries to distract a widow from her bereavement by dragging her off to see “The Miracle Worker”, an affecting play about the handicapped young Keller: “I know when you see that poor little blind, deaf, and dumb girl running around the stage spelling out ‘water' it's going to put your own troubles in perspective.” When Mr Malone veers into the swagger of detective fiction, the tough-guy quips are sharp: “Between love and chapter 11 there's a short straight line.” In all, whether they swan abroad or stay home, the ladies in this year's collections walk tall.

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By Michael Malone.
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Books in brief

Globalisation under scrutiny

May 2nd 2002
From The Economist print edition

Three new books take the globalisation debate a step further

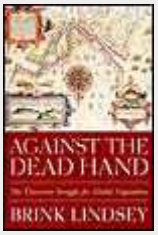
GLOBALISATION is often described as an irresistible new force that, depending on your perspective, will either wreck or save the planet. Brink Lindsey provides an eloquent, much needed corrective by putting international integration into historical context.

Mr Lindsey points out that today's period of globalisation has a precursor in the free markets and economic integration of the mid-19th century. That early bout, however, was cruelly interrupted by what Mr Lindsey calls the industrial counter-revolution: an enthusiasm for collectivism, for national economic planning, and, in its most extreme cases, for communist economies. For much of the 20th century, the invisible hand of the market gave way, he writes, to the dead hand of the state.

That changed when large parts of the world emerged from communism and statism. But the process is far from finished. With his stories from the Russian steel mills of Magnitogorsk to backyard makers of “boogis” (bare-boned home-made vehicles) in India, Mr Lindsey explains how the effects of state ownership, price controls, trade barriers and other leftovers from the statist era still grossly impede the global economy.

He regards the failings attributed to globalisation (the financial crises of the late 1990s, for instance) as the result of a collision between markets and statism. Yes, globalisation has been unstable. The cause is less market liberalisation as such than the fact that the liberalisation remains incomplete. At times Mr Lindsey's faith in the market may be extreme, but mostly this book is full of elegantly argued good sense.

Against the Dead Hand: The Uncertain Struggle for Global Capitalism
By Brink Lindsey



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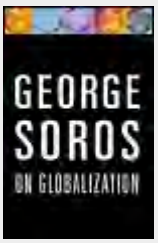
GEORGE SOROS has had two distinguished careers, as a financier and philanthropist. Unfortunately, his third career, as an author and public intellectual, shows less promise. In the past few years, Mr Soros has written several books, including “The Alchemy of Finance” and “The Crisis of Global Capitalism”. In his latest book, “On Globalization”, Mr Soros demonstrates that he has laudable goals and some good instincts. He wants more money spent on global public goods and foreign aid. He believes there are better ways to deliver foreign aid than through governments. He thinks international institutions should be improved, not disbanded. But his practical solutions are unfocused. His main idea for tempering globalisation is for the IMF to issue “special drawing rights”—its quasi-currency. Poor countries would add these SDRs to their reserves; rich countries would donate them for foreign aid.

Mr Soros seems to think that creating quasi-money constitutes a cost-free way to raise real resources. As a financier, he must know better.

On Globalization
By George Soros



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The Chastening: Inside the Crisis that Rocked the Global

the collapse of Long-Term Capital Management, Mr Blustein describes the efforts to deal with what President Clinton dubbed “the biggest financial challenge facing the world in a half century.” A handful of people at the top of the IMF and the Treasury acted to stem currency and financial crises, primarily with IMF loans. Mr Blustein shows how improvised those efforts were and how close the financial system came to failure. His book should be read by anyone wanting to understand, from the inside, how the international financial system really works.

Financial System and Humbled the IMF
By Paul Blustein

PublicAffairs; 448 pages; $30 £19.99

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Ruth Handler

May 2nd 2002
From The Economist print edition

Ruth Handler, creator of the Barbie doll, died on April 27th, aged 85

Reuters

THE Barbie doll is 43 this year, a great age for a toy. Most toys have cruelly short lives. Who now remembers the Cabbage Patch Kids, Tiny Tears, Thunderbirds? They lie discarded in the toy cupboards of the rich world. Barbie has outlived them all. No one has been able to say why, not even Ruth Handler, Barbie's creator. Longevity in toyland is as much a mystery as it is in real life. When pressed by reporters why Barbie had done so well Mrs Handler said, smilingly, “I was a marketing genius.” Perhaps she was. But no other products by Mattel, the firm she helped to found, did as well, and some were flops.

Still, America is happy to celebrate success, whatever its mystery, and Barbie gained fame not simply as a product but as an icon. Andy Warhol produced an image of Barbie, to be applauded alongside that of Marilyn Monroe. At one time you could hardly switch on the radio in America without hearing the song “Barbie Girl”, albeit by a Danish group, Aqua: “Life in plastic/It's fantastic.” A Barbie doll was buried in an American government time capsule as representative of life in the 20th century. Barbie was said to be “the archetypal woman”, a modern Mona Lisa. On television feminists said Barbie was a bimbo and bad for children. Mrs Handler retorted that Barbie offered children choices of what to be when they grew up. Academe bent its mind to the Barbie phenomenon. Students on a sociology course were set the following exercise: “What criticisms have been made of Barbie as a role model? Do you agree with this criticism? In your opinion should the manufacturers be sensitive to this criticism? There are no ‘right' answers to these questions, but you should develop a line of reasoning that reflects your values.”

A garage in California

Ruth Handler was herself a success story in an honoured American tradition. Her parents had arrived in the United States in a steamship, travelling steerage, the cheapest accommodation, and settled in Denver. Her father was a blacksmith who had brought his family from Poland so that he would not be conscripted into the Russian army. Mother never felt very well, exhausted after bearing ten children. But big families have a way of looking after themselves, and Ruth, the youngest, says she was well cared for.

At the age of 19 she headed for Hollywood. She did not make it into the film business. She took a course in industrial design, met a boy on the same course and married him. Mattel was started in a garage, adding to another bit of American industrial lore. Ruth Handler and her husband at first made picture frames, then furniture for dolls' houses, then toys, including a child's guitar that found a market. The firm seems to have done reasonably well and in the 1950s Mrs Handler had a holiday in Europe. In Switzerland she came across a German-made doll about 11in tall called Blonde Lilli, of improbable proportions, dressed in skimpy clothes, and presumably designed to raise the ambitions of young men.

Suppressing her American blushes, Mrs Handler bought three and took them back to America. She said she had been thinking for some time of producing a “grown-up” doll for children, but the men in her firm said there would be no demand for one: what children liked was dolls that looked like babies. Inspired by Lilli, Mrs Handler designed a respectable American doll called Barbie (her daughter's name) with breasts but without nipples and wearing clothes that were pretty but non-provocative. The first dolls were made in Japan and in 1959 “Barbie the teenage model” made its debut at the American Toy Fair in New York. It was the success of the show, selling 350,000 Barbies in the first year. Since then more than a billion Barbies have been sold worldwide.

According to Mattel, an American girl aged up to 11 is likely to own ten Barbie dolls. French children are said to own five. But several million grown-up women are also said to own Barbies. “She is more than a doll to them, whatever their age,” Mrs Handler said. “She has become part of them.” There are Barbie collectors of both sexes: a 1959 Barbie that sold for $3 is now said to be worth $5,000 in good condition.

What apparently sustains demand for the doll is that Barbies come in all guises, as a dancer, a police officer, an astronaut, a physician, a talking Barbie that says, “Want to go shopping?” There is a Chinese Barbie, an American Indian Barbie, a black Barbie, just about every sort of Barbie except its shameless forebear Lilli. Barbie retains an almost sexless body that can puzzle knowing children who wonder how Barbie was born without a belly button and has no obvious means of reproduction. “Hey, Momma...?”“That's enough, dear, or I'll take Barbie away.”

In defending Barbie against the feminists Mrs Handler said her creation is a career woman and not at all empty headed. But Barbie has had so many careers, and at 43 marriage seems to be a declining prospect. There is a boyfriend called Ken, named after another of Mrs Handler's children. Barbie and Ken have been together for years. What are Ken's intentions? Barbie was born in the innocent 1950s, and may find the mores of these changeable times hard to cope with. Barbie's friends of all ages are concerned.

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Overview

May 2nd 2002
From The Economist print edition

America's economy grew by a whopping 5.8% in the first quarter. However, more than half of that growth came from firms reducing their inventories at a much slower pace than in the fourth quarter of last year. Spending on goods and services excluding inventories rose at a more modest annual rate of 2.6%.

Figures for April suggest that growth may be slowing. The Conference Board's survey of consumer confidence showed that consumers became more cautious in April. The Institute for Supply Management's monthly manufacturing survey signalled a further rise in output in April, but at a slower pace than in March. In the first quarter, the employment cost index rose at its slowest rate in three years.

The dollar's trade-weighted index fell by 1.2%, despite (or, perhaps in response to) comments from Paul O'Neill, America's Treasury Secretary, that the administration's strong dollar policy had not changed.

Japan's industrial production rose by 0.5% in March, but that still left it 10% lower than a year earlier.

Britain's GDP rose by a feeble 0.3% at an annual rate in the first quarter. Not only was this much less than expected, but it followed zero growth in the fourth quarter. As a result, Britain's economic growth slowed to only 1% over the year. These figures seemed to contradict other recent data showing falling British unemployment, strong retail spending, and house prices rising by no less than 17% in the year to April.

Industrial production in the **euro area** edged up by 0.2% in February, but that still left it 3.3% lower than a year earlier. Unemployment in the region held steady at 8.4% in March. **France's** jobless rate edged up to 9.1%; Spain's remained at 12.9%.

Inflation in the **euro area** fell to 2.2% in April, only a shade above the 2% ceiling set by the European Central Bank. **French** producer prices fell by 0.7% in the year to March. **Italian** wages rose by 3.2% over the same 12 months—their strongest rise since December 1997.

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Output, demand and jobs

May 2nd 2002
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2002	2003	latest	latest	latest	year ago
Australia	+ 5.2	+ 4.1 Q4	+ 3.8	+ 3.9	+ 2.5 Q4	+ 4.8 Q4	6.3 Mar	6.5
Austria	– 0.7	– 0.4 Q4	+ 1.2	+ 2.6	– 5.9 Jan	+ 0.7 Jan	4.0 Mar	3.4
Belgium	– 0.8	+ 0.1 Q4	+ 1.3	+ 2.9	– 6.5 Feb	+ 6.6 Feb	10.8 Mar*	10.3
Britain	+ 0.3	+ 1.0 Q1	+ 1.9	+ 2.9	– 5.1 Feb	+ 5.7 Mar	5.1 Feb†	5.2
Canada	+ 2.0	+ 0.9 Q4	+ 2.3	+ 3.5	– 0.8 Feb	+ 5.7 Jan	7.7 Mar*	7.0
Denmark	+ 0.7	+ 0.7 Q4	+ 1.5	+ 2.4	– 1.6 Feb	+ 2.0 Feb	5.0 Mar	5.4
France	– 1.4	+ 0.5 Q4	+ 1.5	+ 2.9	– 0.6 Feb	– 0.4 Feb	9.1 Mar	8.7
Germany	– 1.0	– 0.1 Q4	+ 0.9	+ 2.5	– 4.8 Feb	– 1.1 Feb	9.6 Mar**	9.3
Italy	– 0.8	+ 0.7 Q4	+ 1.3	+ 2.9	– 3.0 Feb	– 0.4 Feb	9.0 Jan	9.8
Japan	– 4.8	– 1.9 Q4	– 1.0	+ 1.1	–10.0 Mar	– 4.6 Feb	5.2 Mar	4.7
Netherlands	nil	+ 0.4 Q4	+ 1.4	+ 2.7	– 4.0 Feb	– 0.7 Nov	2.2 Mar§	2.2
Spain	+ 0.7	+ 2.3 Q4	+ 2.0	+ 3.2	– 0.2 Feb	na	12.9 Mar	13.1
Sweden	+ 1.4	+ 1.1 Q4	+ 1.7	+ 3.0	– 1.7 Feb	+ 2.4 Feb	3.8 Mar*	3.9
Switzerland	+ 0.1	+ 0.4 Q4	+ 1.0	+ 2.2	– 1.0 Q4	+ 3.8 Feb	2.6 Mar*	1.8
United States	+ 5.8	+ 1.6 Q1	+ 2.5	+ 3.5	– 2.9 Mar	+ 6.1 Mar	5.7 Mar	4.3
Euro area	– 0.2	+ 0.6 Q4	+ 1.3	+ 2.8	– 3.3 Feb	+ 1.3 Feb	8.4 Mar	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 1.8	– 0.9 Q4	na	na	– 4.9 Mar	+ 1.3 Jan	9.5 Mar*	9.6
Greece	na	+ 3.7 Q4	na	na	– 0.8 Jan	+ 6.8 Dec	na	na
Iceland	na	+ 3.1 2001	na	na	+ 2.5 2000	na	2.7 Mar*	1.5
Ireland	na	nil Q4	na	na	– 1.6 Feb	+ 5.0 Feb	4.3 Mar	3.6
Luxembourg	na	+ 5.1 2001	na	na	– 3.3 Jan	+ 5.4 Dec	2.9 Feb	2.7
New Zealand	+ 2.6	+ 2.9 Q4	na	na	+ 3.5 Q4	+ 7.4 Q4	5.4 Q4	5.6
Norway	+ 1.0	+ 1.8 Q4	na	na	+ 6.2 Feb	+ 2.9 Mar	3.7 Q1	3.7
Portugal	+ 1.8	+ 1.0 Q4	na	na	+ 0.5 Feb	+ 1.1 Feb	4.1 Q4*	3.8

*Not seasonally adjusted. †Dec-Feb; claimant count rate 3.1% in Mar. §Jan-Mar. **EU harmonised rate 8.1% in Mar.

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Prices and wages

May 2nd 2002
From The Economist print edition

% change at annual rate

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2002	2003	latest		year ago	latest		year ago
Australia	+ 2.9	Q1	+ 6.0	+ 2.5	+ 2.4	+ 0.5	Q1	+ 5.2	+ 4.9	Q4	+ 5.4
Austria	+ 1.9	Mar	+ 2.7	+ 1.6	+ 1.7	– 0.3	Mar	+ 2.7	+ 2.4	Mar	+ 2.6
Belgium	+ 1.8	Apr	+ 2.8	+ 1.8	+ 1.7	+ 0.4	Mar	+ 3.2	+ 3.1	Q1	+ 1.9
Britain	+ 1.3	Mar	+ 2.3	+ 2.1	+ 2.5	– 0.3	Mar	+ 1.0	+ 1.9	Feb	+ 5.4
Canada	+ 1.8	Mar	+ 2.5	+ 1.3	+ 2.1	– 1.2	Mar	+ 2.4	+ 3.3	Feb	+ 0.3
Denmark	+ 2.6	Mar	+ 2.3	+ 1.9	+ 2.0	+ 0.8	Mar	+ 3.0	+ 4.1	Q4	+ 3.8
France	+ 2.1	Mar	+ 1.3	+ 1.4	+ 1.5	– 0.7	Mar	+ 2.9	+ 4.1	Q4	+ 5.0
Germany	+ 1.6	Apr	+ 2.9	+ 1.4	+ 1.4	nil	Mar	+ 3.3	+ 2.3	Feb	+ 2.4
Italy	+ 2.5	Mar	+ 2.8	+ 1.9	+ 1.9	– 1.3	Mar	+ 4.2	+ 3.2	Mar	+ 2.0
Japan	– 1.2	Mar	– 0.7	– 0.8	– 0.5	– 1.0	Mar	+ 1.0	– 1.0	Mar	+ 0.6
Netherlands	+ 3.6	Mar	+ 4.6	+ 2.9	+ 2.3	– 1.8	Mar	+ 5.7	+ 3.6	Feb	+ 4.4
Spain	+ 3.2	Mar	+ 3.9	+ 2.3	+ 2.4	nil	Mar	+ 3.2	+ 3.7	Q4	na
Sweden	+ 2.9	Mar	+ 1.9	+ 2.2	+ 2.0	– 0.4	Mar	+ 2.6	+ 2.6	Feb	+ 2.8
Switzerland	+ 1.1	Apr	+ 1.2	+ 0.6	+ 1.1	– 1.3	Mar	+ 0.5	+ 1.3	2000	+ 0.3
United States	+ 1.5	Mar	+ 2.9	+ 1.4	+ 2.2	– 1.4	Mar	+ 3.0	+ 3.5	Mar	+ 4.3
Euro area	+ 2.2	Apr	+ 2.9	+ 1.7	+ 1.7	– 1.1	Feb	+ 4.6	+ 3.0	Q4	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.8	Mar	+ 2.8	na	na	– 0.8	Mar	+ 2.1	+ 4.3	Q4	+ 5.0
Greece	+ 4.0	Mar	+ 3.0	na	na	+ 2.8	Feb	+ 4.8	na		na
Iceland	+ 7.5	Apr	+ 4.5	na	na	+ 8.8	Apr	+ 4.2	+ 8.7	Mar	+ 9.2
Ireland	+ 4.8	Mar	+ 5.4	na	na	+ 2.3	Feb	+ 3.5	+ 8.1	Q4	+ 6.4
Luxembourg	+ 2.1	Mar	+ 2.9	na	na	– 2.5	Feb	+ 4.5	+ 2.4	Jan	+ 7.6
New Zealand	+ 2.6	Q1	+ 3.1	na	na	+ 1.8	Q4	+10.7	+ 2.2	Q4	+ 1.6
Norway	+ 1.0	Mar	+ 3.7	na	na	– 4.5	Mar	– 0.1	+ 4.5	Q4	+ 4.3
Portugal	+ 3.2	Mar	+ 5.1	na	na	– 5.0	Mar	+ 4.7	+ 2.4	Apr	na

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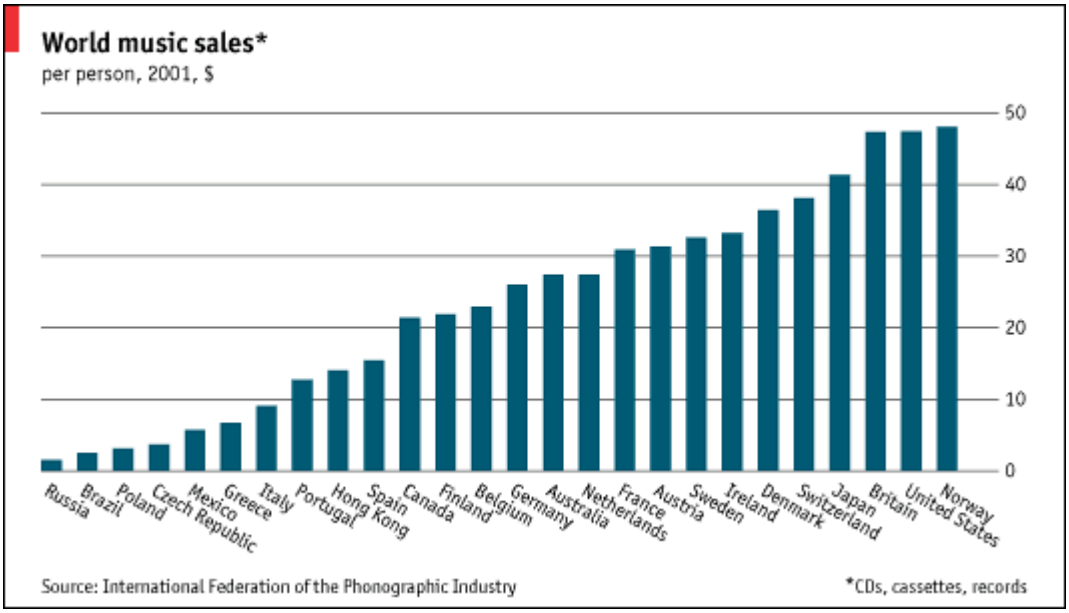
World music sales

May 2nd 2002
From The Economist print edition



World music sales fell by 5% in value and 6.5% in volume in 2001. The market for recordings is suffering from widespread copying of music downloaded from the Internet. Half of all blank writeable CDs are bought to copy music. Only a few countries, including Britain, where sales rose by 5% in value, bucked the trend. The wide disparity in national sales suggests that low-spending countries may see renewed growth in the future.

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Money and interest rates

May 2nd 2002
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (May 1st 2002)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+19.0	+13.9	Mar	4.62	4.88	5.02	6.09	5.82	6.87
Britain	+ 7.2	+ 5.4	Mar	4.06	5.25	4.68	4.77	5.04	6.08
Canada	+11.7	+ 5.3	Mar	2.41	4.43	4.16	5.62	5.75	7.02
Denmark	+ 5.8	+ 5.3	Mar	3.73	5.32	4.31	5.29	5.24	6.99
Japan	+24.4	+ 3.8	Mar	0.03	0.02	0.03	1.36	1.36	1.47
Sweden	+ 8.8	+ 6.2	Dec	4.30	4.01	5.03	5.55	5.07	5.64
Switzerland	+ 6.6	+ 3.1	Mar	1.50	3.19	2.53	3.39	3.45	4.33
United States	+ 7.0	+10.1	Mar	1.77	4.17	3.17	5.06	5.29	6.89
Euro area†	+ 5.8	+ 7.3	Mar	3.39	4.78	4.05	5.05	4.95	5.83

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 5.57%, Japan No.238 1.37%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.001%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS Warburg, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

May 2nd 2002
From The Economist print edition

1995=100

	Apr 23rd	Apr 30th*	% change on one month	% change on one year
Dollar index				
All items	69.8	68.8	– 1.6	– 2.9
Food	70.0	68.6	– 3.0	+ 0.5
Industrials				
All	69.5	69.1	+ 0.3	– 7.1
Nfa†	68.6	68.3	– 1.2	– 5.4
Metals	70.3	69.7	+ 1.6	– 8.5
Sterling index				
All items	76.0	74.5	– 2.7	– 4.5
Euro index				
All items	103.2	100.4	– 3.7	– 3.9
Yen index				
All items	96.4	94.0	– 5.2	+ 2.1
Gold				
$ per oz	302.80	307.70	+ 0.8	+16.6
West Texas Intermediate				
$ per barrel	26.18	26.85	– 2.0	– 5.3

* Provisional. † Non-food agriculturals.

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Stockmarkets

May 2nd 2002
From The Economist print edition

Market indices

	May 1st	2002 high	2002 low	% change on one week	% change on record high	% change on Dec 31st 2001 in local currency	% change on Dec 31st 2001 in $ terms
Australia (All Ordinaries)	3,308.8	3,440.0	3,299.5	- 0.5	- 3.8	- 1.5	+ 3.6
Austria (ATX)	1,344.7§	1,344.7	1,114.4	+ 2.1	-22.6	+17.9	+20.0
Belgium (Bel 20)	2,811.1§	2,899.8	2,622.4	- 2.8	-23.7	+ 1.0	+ 2.8
Britain (FTSE 100)	5,125.5	5,323.8	5,024.1	- 1.8	-26.0	- 1.8	- 1.3
Canada (Toronto Composite)	7,647.3	7,958.1	7,418.1	- 0.9	-32.9	- 0.5	+ 1.8
Denmark (KBX)	218.8	233.4	213.3	+ 1.5	-27.5	- 2.6	- 0.9
France (SBF 250)	2,954.3§	3,081.9	2,782.5	- 1.3	-32.7	- 0.9	+ 0.8
(CAC 40)	4,462.7§	4,688.0	4,239.0	- 1.4	-35.5	- 3.5	- 1.8
Germany (Xetra DAX)	5,041.2§	5,462.6	4,745.6	- 2.3	-37.5	- 2.3	- 0.6
Italy (BCI)	1,462.0§	1,513.0	1,344.9	- 2.3	-33.0	+ 2.0	+ 3.8
Japan (Nikkei 225)	11,552.8	11,919.3	9,420.9	- 1.0	-70.3	+ 9.6	+12.7
(Topix)	1,086.9	1,125.4	922.5	- 1.1	-62.3	+ 5.3	+ 8.3
Netherlands (AEX)	511.3§	531.2	478.3	- 1.8	-27.1	+ 0.9	+ 2.7
Spain (Madrid SE)	828.0§	848.1	773.2	- 1.6	-27.8	+ 0.4	+ 2.2
Sweden (Affarsvarlden Gen)	204.1§	236.8	201.2	+ 0.7	-49.0	-11.8	- 9.5
Switzerland (Swiss Market)	6,557.6§	6,694.1	6,105.2	- 1.8	-22.0	+ 2.2	+ 5.7
United States (DJIA)	10,059.6	10,635.3	9,618.2	+ 0.3	-14.2	+ 0.4	+ 0.4
(S&P 500)	1,086.5	1,172.5	1,065.5	- 0.6	-28.9	- 5.4	- 5.4
(Nasdaq Comp)	1,677.5	2,059.4	1,656.9	- 2.1	-66.8	-14.0	-14.0
Europe (FTSE Eurotop 300)*	1,221.6	1,279.7	1,185.5	- 1.6	-28.4	- 3.1	- 1.4
Euro area (FTSE Ebloc 100)*	1,061.0	1,125.1	1,013.0	- 1.6	-31.6	- 4.6	- 2.9
World (MSCI)†	975.2	1,024.4	937.0	- 0.3	-32.7	na	- 2.8
World bond market (Salomon)‡	448.0	447.9	430.3	+ 1.0	- 2.6	na	+ 1.9

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms. ‡Salomon Smith Barney World Government Bond Index, total return, in $ terms. §April 30th.

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Trade, exchange rates and budgets

May 2nd 2002
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2002	Current account The Economist poll % of GDP, forecast 2003	Exchange rate trade-weighted† May 1st	Exchange rate trade-weighted† year ago	Currency units per $ May 1st	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2002‡
Australia	+ 1.5 Mar	− 9.2 Q4	− 3.5	− 3.7	75.4	70.6	1.86	1.92	2.71	1.68	1.46	0.1
Austria	− 3.3 Jan	− 3.6 Feb	− 2.2	− 2.0	100.2	100.3	1.10§	1.12	1.61	–	0.87	-0.3
Belgium	+ 11.5 Jan	+ 13.0 Dec	+ 4.8	+ 4.8	99.1	99.0	1.10§	1.12	1.61	–	0.87	nil
Britain	− 47.2 Feb	− 25.1 Q4	− 1.9	− 1.9	106.6	105.7	0.68	0.70	–	0.62	0.54	-0.8
Canada	+ 37.6 Feb	+ 18.9 Q4	+ 1.9	+ 2.1	77.1	77.9	1.56	1.53	2.28	1.41	1.22	1.0
Denmark	+ 7.2 Feb	+ 4.1 Feb	+ 2.5	+ 2.3	102.2	101.9	8.20	8.37	12.0	7.43	6.43	2.2
France	+ 4.5 Feb	+ 24.4 Feb	+ 1.8	+ 1.7	101.7	101.7	1.10§	1.12	1.61	–	0.87	-2.0
Germany	+ 90.3 Feb	+ 15.8 Feb	+ 0.3	+ 0.4	98.8	98.7	1.10§	1.12	1.61	–	0.87	-2.8
Italy	+ 8.5 Feb	+ 1.7 Jan	nil	− 0.1	72.6	72.6	1.10§	1.12	1.61	–	0.87	-1.4
Japan	+ 70.1 Feb	+ 90.0 Feb	+ 2.5	+ 2.5	131.2	138.0	127	122	186	116	–	-8.0
Netherlands	+ 22.4 Feb	+ 11.8 Q4	+ 3.7	+ 4.0	98.0	97.9	1.10§	1.12	1.61	–	0.87	0.1
Spain	− 38.3 Jan	− 15.1 Jan	− 2.1	− 1.8	74.3	74.2	1.10§	1.12	1.61	–	0.87	-0.3
Sweden	+ 13.5 Feb	+ 7.4 Feb	+ 2.3	+ 2.6	75.4	76.5	10.2	10.3	14.9	9.26	8.02	2.1
Switzerland	+ 1.8 Mar	+ 24.6 Q4	+ 9.4	+ 9.5	113.9	107.7	1.61	1.73	2.35	1.45	1.26	na
United States	−423.2 Feb	−417.4 Q4	− 4.2	− 4.5	119.6	118.5	–	–	1.46	0.91	0.78	-1.0
Euro area	+ 50.3 Feb	− 5.8 Feb	+ 0.3	+ 0.4	79.1	79.0	1.10	1.12	1.61	–	0.87	-1.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 12.4 Feb	+ 7.5 Feb	na	na	78.3	78.1	1.10§	1.12	1.61	–	0.87	3.2
Greece	− 19.1 Dec**	− 7.2 Dec	na	na	57.5	57.4	1.10§	1.12	1.61	–	0.87	0.4
Iceland	+ 9.3 Feb	− 0.4 Q4	na	na	na	na	93.1	100.0	136	84.3	73.0	-0.5
Ireland	+ 31.9 Jan	− 1.2 Q3	na	na	87.5	87.3	1.10§	1.12	1.61	–	0.87	0.1
Luxembourg	− 2.9 Feb	+ 0.4 Q3	na	na	99.1	99.0	1.10§	1.12	1.61	–	0.87	2.2
New Zealand	+ 0.2 Feb	− 1.6 Q4	na	na	85.5	80.4	2.23	2.36	3.26	2.02	1.75	0.1
Norway	+ 24.6 Mar	+ 22.2 Feb	na	na	101.5	94.5	8.36	9.07	12.2	7.57	6.55	14.0
Portugal	− 13.7 Jan	− 10.2 Jan	na	na	89.3	89.3	1.10§	1.12	1.61	–	0.87	-2.4

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate. §Now using euro only. **Corrected.

Text refers only to the first 16 countries listed

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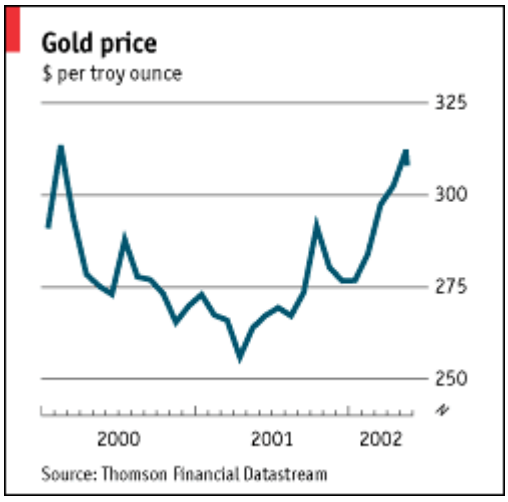
Gold price

May 2nd 2002
From The Economist print edition

Gold touched a two-year high of $312 an ounce on April 29th, in response to a weaker dollar and concerns over instability in the Middle East. Producers are also unwinding their price hedges, which had been putting downward pressure on the price.



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Overview

May 2nd 2002
From The Economist print edition

Industrial output is picking up in emerging Asian economies. In **Thailand** it jumped by 2.9% in March, lifting the annual growth rate to 8.4%. In the **Philippines** it rose by 2.2% in the year to February. **Singapore's** output fell by 2.9% in the year to March, a much smaller decline than in previous months.

South Korea's consumer prices rose by a faster-than-expected 0.6% in April, raising the 12-month rate from 2.3% to 2.5%.

In **Israel**, industrial output fell by 6.9% in the year to February.

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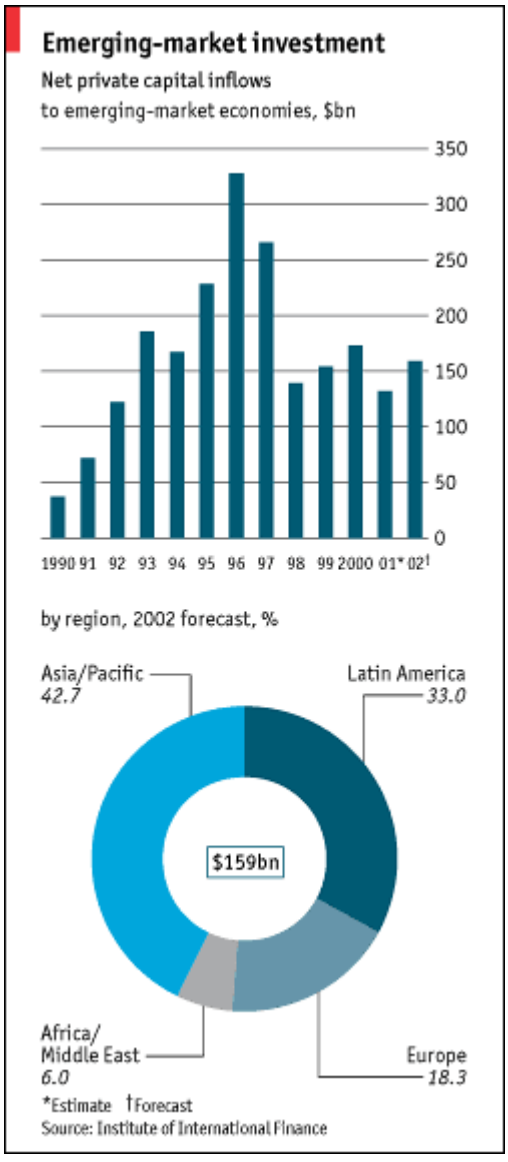
Emerging-market investment

May 2nd 2002
From The Economist print edition

The Institute of International Finance, a Washington club of financial firms, expects private capital flows to emerging markets to rise in 2002 to $159 billion, after dipping in 2001. The IIF predicts that about half the forecast increase of $27 billion will go to European countries, with the rest evenly split between Asia and Latin America. Portfolio equity investment and debt investment should both rise, and net outflows to foreign banks should fall. Direct equity investment is expected to be weaker.



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Economy

May 2nd 2002
From The Economist print edition

	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.6	Q1	+10.9	Mar	– 0.6	Mar	+25.5	Mar	+21.2	2001§	220.8	Jan
Hong Kong	– 1.6	Q4	– 9.3	Q4	– 2.2	Mar	– 9.6	Mar	+12.0	Q4	110.2	Mar
India	+ 6.3	Q4	+ 2.3	Feb	+ 5.2	Feb	– 6.0	Feb	– 0.1	Q4	51.1	Mar
Indonesia	+ 4.1	Q4	– 2.2	Q3	+13.3	Apr	+26.0	Mar	+ 8.4	Q3	27.2	Mar
Malaysia	– 0.5	Q4	+ 2.9	Feb	+ 2.1	Mar	+14.1	Mar	+ 6.9	Q4	31.5	Mar
Philippines	+ 3.8	Q4	+ 2.2	Feb‡	+ 3.6	Mar	+ 2.6	Feb	+ 4.9	Jan	14.9	Mar
Singapore	– 2.6	Q1	– 2.9	Mar	– 0.9	Mar	+ 5.3	Mar	+17.9	Q4	75.9	Mar
South Korea	+ 3.7	Q4	– 2.6	Feb	+ 2.5	Apr	+ 9.3	Apr	+ 7.6	Mar	106.0	Mar
Taiwan	– 2.7	Q4	+ 0.4	Mar	nil	Mar	+17.5	Mar	+19.0	Q4	128.0	Mar
Thailand	+ 2.1	Q4	+ 8.4	Mar	+ 0.4	Apr	+ 3.2	Mar	+ 6.6	Mar	33.2	Feb
Argentina	–10.7	Q4	–16.7	Mar	+ 7.9	Mar	+ 8.3	Feb	– 4.4	Q4	13.9	Feb
Brazil	– 0.7	Q4	– 1.4	Feb	+ 9.7	Mar	+ 4.4	Mar	–19.8	Mar	35.9	Feb
Chile	+ 1.7	Q4	+ 0.9	Feb	+ 2.6	Mar	+ 1.5	Mar	– 0.9	Q4	14.0	Feb
Colombia	+ 1.7	Q4	– 0.5	Feb	+ 5.9	Mar	+ 0.4	Feb	– 1.7	Q4	10.1	Mar
Mexico	– 1.6	Q4	– 1.8	Feb	+ 4.7	Mar	– 9.4	Mar	–17.1	Q4	47.1	Feb
Peru	+ 3.3	Feb	+ 1.5	Jan	+ 0.1	Apr	– 0.1	Feb	– 1.1	Q4	8.3	Mar
Venezuela	+ 2.8	Q3	+ 7.9	Oct	+17.6	Mar	+ 9.8	Q4	+ 4.4	Q4	7.6	Jan
Egypt	+ 4.9	2001†	+ 7.8	2001†	+ 2.4	Jan	– 8.6	Dec	– 0.1	Q4	12.9	Dec
Israel	– 3.4	Q4	– 6.9	Feb	+ 4.3	Mar	– 6.5	Mar	– 1.7	Q4	24.2	Mar
South Africa	+ 1.8	Q4	+ 5.5	Feb	+ 6.6	Mar	+ 3.8	Mar	– 0.2	Q4	6.0	Mar
Turkey	–10.4	Q4	– 4.5	Feb	+65.1	Mar	– 7.4	Feb	+ 4.2	Jan	20.5	Mar
Czech Republic	+ 3.2	Q4	+ 5.8	Feb	+ 3.7	Mar	– 2.7	Mar	– 2.7	Q4	14.6	Mar
Hungary	+ 3.3	Q4	nil	Feb	+ 5.9	Mar	– 2.3	Feb	– 1.4	Feb	9.7	Mar
Poland	+ 0.3	Q4	– 3.2	Mar	+ 3.3	Mar	–11.1	Mar	– 7.2	Mar	26.1	Mar
Russia	+ 4.3	Q4	+ 3.7	Mar	+17.0	Mar	+45.8	Feb	+35.1	Q4	33.2	Mar
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 6.9	Dec	+ 4.6	Feb	– 1.0	Mar	+ 0.3	2001†	3.6	Jan
Saudi Arabia	+ 1.7	2001§	na		nil	Dec	+37.5	2001§	+ 8.3	2001	18.8	Feb

*Excluding gold, except Singapore; IMF definition. ‡New series. †Year ending June. §Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

May 2nd 2002
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	May 1st		Dec 31st 2001	
	May 1st	year ago	May 1st	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.1	na	1,742.0‡	+3.5	+ 1.7	+ 1.7
Hong Kong	7.80	7.80	11.4	1.96	11,497.6‡	+0.9	+ 0.9	+ 0.9
India	48.9	46.8	71.5	5.97	3,338.2‡	-2.2	+ 2.3	+ 0.8
Indonesia	9,328	11,225	13,637	17.17	534.7	-1.8	+ 36.4	+ 52.1
Malaysia	3.80	3.80	5.56	3.25	794.0‡	-0.7	+ 14.1	+ 14.1
Philippines	50.6	50.7	74.0	6.44	1,346.1‡	-0.6	+ 15.2	+ 17.5
Singapore	1.81	1.82	2.65	0.88	1,725.4‡	-0.5	+ 6.3	+ 8.4
South Korea	1,289	1,307	1,885	4.72	842.3‡	-8.0	+ 21.4	+ 23.7
Taiwan	34.7	32.9	50.7	2.55	6,065.7‡	-6.0	+ 9.3	+ 10.3
Thailand	43.3	45.5	63.3	2.13	371.4‡	-2.5	+ 22.2	+ 24.9
Argentina	2.96	1.00	4.32	na	387.8‡	-7.6	+ 31.3	- 55.6
Brazil	2.36	2.23	3.45	18.39	13,085.1‡	-2.2	- 3.6	- 5.7
Chile	647	603	946	4.32	5,224.0‡	-0.4	- 3.2	- 1.1
Colombia	2,279	2,345	3,331	10.02	1,132.5‡	-0.7	+ 5.8	+ 5.7
Mexico	9.44	9.28	13.8	5.67	7,480.7‡	-0.3	+ 17.4	+ 14.0
Peru	3.43	3.59	5.01	2.47	1,261.8‡	nil	+ 7.4	+ 7.9
Venezuela	856	712	1,251	44.05	6,712.6‡	-1.3	+ 2.2	- 9.5
Egypt	4.64	3.89	6.79	7.20	5,257.6‡	+0.3	- 0.3	- 1.7
Israel	4.88	4.14	7.13	2.73	367.1	-1.6	- 17.8	- 25.7
South Africa	10.6	8.03	15.5	11.45	11,029.7‡	-2.0	+ 5.6	+ 19.8
Turkey	1,363,500	1,166,500	1,993,437	43.00	11,479.7	-2.5	- 16.7	- 11.1
Czech Republic	33.9	38.9	49.5	3.81	448.6‡	+0.7	+ 13.7	+ 19.3
Hungary	268	300	392	8.45	8,673.6‡	+1.1	+ 21.6	+ 24.5
Poland	3.99	3.96	5.83	10.14	15,122.1‡	+1.4	+ 8.6	+ 7.6
Russia	31.2	28.9	45.7	23.00	386.1§‡	+0.3	+ 52.1	+ 48.5
EMF (MSCI)*	1.00	1.00	1.46	na	352.8	-3.0	na	+ 11.1
EMBI+†	1.00	1.00	1.46	na	215.4	-0.9	na	+ 7.5

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. § In $ terms. ‡April 30th.
Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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